STRUCTURING AMERICAN INDUSTRY FOR GLOBAL COMPETITION

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC STABILIZATION

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

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STRUCTURING AMERICAN INDUSTRY FOR GLOBAL COMPETITION

TUESDAY, MARCH 11, 1986

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC STABILIZATION,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met at 11:06 a.m., in room 2128 of the Rayburn House Office Building, Hon. John J. LaFalce (chairman of the subcommittee) presiding.

Present: Chairman LaFalce, Representatives Kaptur, Levin, Torres, Carper, Shumway, McKinney, Wortley, and McCandless.

Chairman LAFALCE. The Subcommittee on Economic Stabilization will come to order.

Our economy continues to have some serious and far-reaching problems. Since 1984, it has been sluggish, growing at a pace of about 2 percent per year. Unemployment remains stuck at approximately 7 percent, well above the 5.8-percent rate in 1979 before the start of the recession. In the manufacturing sector, almost 2 million jobs have been lost since 1979.

Since 1980, U.S. exports of manufactured goods have dropped by almost 20 percent in real terms, while our imports of manufactured goods have increased by 67 percent over that same period. The trade deficit for 1985 was almost $150 billion. And for the first time since World War I, the United States has become a net debtor nation.

Productivity growth has also been extremely disappointing and has improved barely 1 percent per year over the past 15 years, compared to Japan's 6 percent per year and Germany's 3½-percent-per-year growth.

In short, the statistical evidence strongly suggests that our economy has not been performing as well as it can. Moreover, specific sectors, industries, and regions have been particularly beset with problems. In almost every product line, covering both smokestack and high-technology industries, we have been losing market share. Import penetration has increased by 65 percent since 1980. Clearly, large segments of the American economy have a competitiveness problem.

Now many reasons have been advanced to explain our competitiveness problem. Among the possible explanations are the overvalued dollar, unfair trading practices by our competitors, the Third World debt crisis, incoherent industrial policies, excessive Govern-

ment regulation, and ill-advised fiscal and monetary policies, to name but a few.

The administration, including President Reagan's Commission on Industrial Competitiveness, has also concluded that our present regime of antitrust laws have adversely affected the Nation's competitiveness and are in need of revision.

The administration has now proposed major changes in our antitrust laws that would greatly relax current restraints on mergers and give the President authority to exempt industries hurt by imports from the antitrust laws.

U.S. companies have argued that the United States is making its antitrust decisions based on the U.S. market alone, while actual competition has become global. The administration emphasizes that the principal competitors of many domestic industries are now large foreign companies and that mergers may better enable them to meet the challenge of foreign competition.

Others have criticized the Reagan administration for being too lenient in antitrust enforcement. Critics of the administration's proposals reject the notion that our antitrust laws have been preventing U.S. producers from achieving competitive production scales and that there is a positive correlation between size and efficiency as the administration's proposals imply.

Rather, they claim there is no evidence that we can improve our competitiveness through relaxation of antitrust enforcement and that such a relaxation might actually detract from our competitiveness.

Today's hearing will examine the following issues: will the proposed changes in antitrust law and enforcement being proposed accomplish their intended purpose of enhancing U.S. competitiveness? Are adequate safeguards being proposed to prevent any anticompetitive results? Do the antitrust laws prevent American producers from achieving the economies of scale necessary to compete? Are American companies too small to compete effectively in international markets? Is there a link between our trade problems and the antitrust laws? Is there a positive correlation between size and competitiveness?

We are fortunate today to have two distinguished witnesses who can speak with authority to these issues. First, Secretary of Commerce Malcolm Baldrige, who has been the most outspoken critic of our antitrust laws within the administration, and the most ardent advocate of change in those laws. And second, Prof. F. Michael Scherer of Swarthmore and the Brookings Institution, who is perhaps this Nation's leading academic expert on industrial organization, and who has seriously questioned the wisdom of any proposal which would lead to increased industry concentration as the solution to our competitiveness problems.

Our first witness will be Secretary Baldrige. But before we go to Secretary Baldrige, I'd like to call upon the ranking minority member, Congressman Shumway.

Mr. SHUMWAY. Thank you, Mr. Chairman.

I commend you for calling this hearing to examine the effect of our antitrust laws on the competitiveness of U.S. industry and whether the administration's proposed changes to these laws will enhance our economic performance in the world market.

I would also like to welcome our witnesses, Dr. Scherer, and in particular, Secretary Baldrige. I know that both are highly respected for their differing views on this complex issue.

Needless to say, the subcommittee should learn a great deal from their testimony today.

The subject of antitrust reform is replete with unknown variables, particularly whether liberalization of the statutes will improve our competitive posture and at the same time, increase our standard of living, provide for fuller employment, and enhance our national security.

However, there are certain factors which are known. For example, the world's trading environment in which we are operating has changed dramatically since the Clayton Act was passed. At that time, the U.S. domestic market was largely self-contained; that is, composed entirely of U.S. companies. We were dominant then; we are not now.

Today, American industry is facing competition from countries such as Japan and the other nations of the Pacific Rim which were not even players in the economic game of 70 years ago. Over 75 percent of our products are subject to intense foreign competition, with exports and imports representing twice as much of our GNP as they did just two decades ago.

In addition to increased competition, our economy has also been faced with an inordinate Federal budget deficit, an overvalued dollar and foreign trade barriers. This has led to charges that our country is nothing more than a free-trade patsy and increased protectionist sentiment here at home.

We must find workable solutions to address these problems and to enhance our competitive posture. One such solution recommended by the President's Commission on Industrial Competitiveness and now offered by the administration is to liberalize the antitrust laws. The premise underlying this proposal is to allow our domestic companies to join forces, particularly where the economies of scale and synergies of effort in R&D and marketing of U.S. products abroad will enhance the competitiveness vis-a-vis our foreign competitors which are not similarly constrained by similar laws.

Of course, the question immediately arises whether big is good and whether linking up with one's competitors will produce the economic competitiveness and prosperity we seek to attain.

These are difficult questions, for which I don't have the answers. I'm hopeful that the witnesses today can shed some light on these issues as we examine the administration's proposal and the future of our economic position.

Thank you, Mr. Chairman.

Chairman LAFALCE. Are there any other members of the subcommittee that have any statements that they would like to make?

Representative Torres.

Mr. TORRES. Thank you, Mr. Chairman.

I want to commend you for calling these hearings that are very important. Your statement is right on target, I believe, as to the most critical economic issues facing our economy today. And certainly, the questions that you raised at the end of your statement are those that I look forward to seeing the Secretary perhaps ad-

dress himself to, not only in terms of the problem, but as to the kinds of solutions that are asked here.

So I welcome the Secretary and I commend you, Mr. Chairman. Thank you.

Chairman LAFALCE. Representative McKinney.

Mr. MCKINNEY. I could do no less than to welcome the Secretary, my fellow nutmegger from the great hardware city, or brass city, of Waterbury, CT.

I would just remind the chairman that it was in this committee that we eviscerated ourselves over the Chrysler issue and sat at that table until 3 and 4 in the morning with the doors carefully locked trying to figure out how to save the Chrysler Corp.

The Mazda Corp. in Japan had some major problems, Mr. Chairman. And because of their amalgamation, their togetherness, and their lack of antitrust laws, it was solved without so much as a wimper and the great little car became "the best-selling car," at that period of time.

It taught me something. I'm totally with the Secretary on this, but I want to add the caveat of how big is good. That's a question I think, we all have on our minds. The trade imbalance in this country distresses me deeply because of the nontrade issues of our European friends who do not have our stringent pollution laws, who do not have our labor unions, who do not have our OSHA, who do not have our this, that, and the other thing. If we wish to keep those, which I most sincerely do, it seems to me that we've either got to relax our antitrust laws and at the very least, allow our basic manufacturing businesses like strip steel and so on to group together—or we're never going to be able to achieve "a pollution-free world" a positive trade balance, and the ability to compete.

I'm glad to see that the Secretary also brought product liability up, which I have to tell you, as an old retailer and small businessman, was a bear.

Somehow or other, there has to be an equal playing field found in this world. This may be a step in the right direction.

I talk too much, anyway, but it's of vital importance that something be done to eliminate the nontariff barriers that exist in world trade. And certainly, size, Government cooperation, and financial interests, are all major problems.

Chairman LAFALCE. Thank you very much.

Any other members?

Mr. McCandless.

Mr. MCCANDLESS. Thank you, Mr. Chairman.

I would like to congratulate you, Mr. Secretary, for appearing before us. We appreciate this. I would like to pose a question which I would appreciate both of you thinking about. I will use very quickly two recent examples and how they relate to what we, I think, are talking about here as antitrust or competition versus industrial base.

Recently, Electrolux of Sweden tendered an offer to White-Westinghouse. It was interesting to note that in the major appliance field, White-Westinghouse currently represents Westinghouse, Kelvinator, Frigidaire, and a number of other brand names familiar to all of us. Completion of this acquisition by a foreign country would make it No. 3 in the world as a producer of household appliances.

One example of how something, I think, is actually taking place, whether we have antitrust laws or not, or whether it's even applicable.

The second example is an agreement to produce a product by Boeing and the Japanese conglomerate, the 7J7 commercial jet and the concern that many people have here about the transfer of technology and ability to do so.

One could rationalize or theorize that the two major companies in question are combining their resources to produce something to merchandise internationally because the research and development is so great that neither one of them can do it themselves, or by doing this, they eliminate one another's competition at some future date on the same product.

For whatever that's worth, Mr. Chairman, I'd like to get some comments from both of our members today as they progress through their presentations.

Chairman LAFALCE. Thank you, Mr. McCandless.

We will now hear from Secretary Baldrige.

STATEMENT OF HON. MALCOLM BALDRIGE, SECRETARY, DEPARTMENT OF COMMERCE

Mr. BALDRIGE. Thank you, Mr. Chairman.

First, I'd like to say that I appreciate this opportunity to testify. Mr. Chairman, on a personal note, I realize and appreciate all you've done as being one of the fathers—perhaps one of the first fathers—of the Export Trading Company Act——

Chairman LAFALCE. Thank you.

Mr. BALDRIGE [continuing]. Because that certainly was a step in the right direction.

I'm pleased to have this opportunity to talk about U.S. firm competitiveness today. The ability of domestic firms—large, medium, and small—to maintain their competitiveness in the face of changing economic conditions is absolutely critical to our economic well-being.

There was a time when the United States was a closed market, but those times are gone. In the postwar era, this country has promoted, both at home and among our trading partners, the policy of free trade. That has been particularly true since 1950. As a result, we're faced with competition from all over the world in almost every sector of our economy. Our ability to compete in an ever-expanding marketplace will have a profound effect on the long-term health of our economy.

Competition in this country used to be narrowly defined. Businessmen could easily assess their competitors, and the adjustments needed by their firms to meet that competition. But today, the situation has changed dramatically. We're encountering competition in new areas from competitors that literally did not exist a few years ago. Basic market structures—capacity, and concentration, for example—can quickly be redefined by decisions made abroad, often by foreign governments for whom the bottom line is not the foremost concern.

In addition, the flexibility of our firms to make the necessary adjustments to this changing competitive market has narrowed at the

same time that it's expanded abroad. For years, U.S. firms have been pervasively regulated at both the Federal and the State levels. For the most part, these regulations are legitimate and they're in the public interest.

But, in many cases, they were not developed with their competitive impact in mind. In particular, the ability of U.S. firms to combine and restructure domestically to meet new competition from abroad is constrained by laws and regulations that were developed when our market was closed. And just as the form of competition we experience has changed, so must these laws and regulations.

The last decade has seen an extraordinary decline in the overall competitiveness of American business. Last year, we had a merchandise trade deficit of $148.5 billion, about four times what it was 3 years ago, after years of surpluses before that. Our trade deficit in 1986 will probably be about as large as last year. It will be probably somewhat larger in the first half and smaller in the second half. The year, as a whole, should be about the same.

The impact of these numbers can be better understood in terms of lost opportunities. I'd like to repeat that because I think it's important—the impact of these numbers can be better understood in terms of lost opportunities.

In 1960, 27 of the world's 30 largest industrial companies—I'm speaking about completely industrial companies, not food or oil, but manufacturing kinds of firms—27 out of the 30 in 1960 were American-owned and operated. By 1984, 24 years later, only 10 of the top 30 are U.S. firms, 20 of the top 30 are foreign-owned.

This shift of large industrial capacity offshore represents lost opportunities, opportunities for American workers and American consumers, and it's allowing our competitors abroad to make major inroads on our once dominant competitive position.

Mr. Chairman, we're not saying that big is good. But we don't want to say big is bad, either. Big is very relevant in some areas, some industries; it's not in others. But that should be decided by the marketplace.

The market share enjoyed by imports in various industries is an example. In 1985, over 75 percent of our industries experienced some degree of import competition. In a few industries, the competition was relatively slight. But in most sectors, foreign competition was substantial and growing. Steel is one example we've heard a lot about, but there are clearly a great number of other industries: Radio and TV receiving equipment; motor vehicles; leather; semiconductors.

There are about 341 industries now encountering import competition, and imports today account for a substantially greater share of domestic comsumption than 10, or even 5, years ago.

While the steady decline of the dollar is gratifying, its effect on our competitive ability will not bite until later in the year. We continue to buy more than we sell abroad, and foreign encroachments on our domestic markets continue to grow. We've got a long way to go to turn this trend around.

I think we may have nearly reached the corner on the trade deficit. I expect the month-to-month trend will be headed down by the end of 1986, partially as a result of the dollar's decline, and we definitely should see improvement in 1987.

But other developments will also be required before we see substantial reductions in our trade deficit. These include: reduced Federal spending, faster economic growth abroad, reduction of unfair trade practices, and a substantial easing of the acute financial difficulties of the high debt, lesser developed countries. We are working on all these fronts, Mr. Chairman, and we're beginning to see some results.

But government has to perform better in what I see as its basic job. We have to provide U.S. firms with an environment in which they can be free from unnecessary government regulation and compete without one hand tied behind their backs. We have to be vigorous in protecting our firms from unfair foreign trading practices and we have to foster an environment in which business enjoys a degree of economic certainty, without being whipsawed by developments that are beyond their control.

In this vein, I want to reiterate our support for the work of the President's Commission on Industrial Competitiveness. Some 90 percent of their recommendations either have been done or are under serious consideration.

Now, Mr. Chairman, I did submit a longer paper because there are other items that are important in considering any structural adjustment for American industries for global competition. But because I think antitrust reform is among the least understood, and at your request, I will shorten this down and just address the antitrust segments of it in this oral part of the presentation.

There is one contribution to American competitiveness which we can achieve relatively quickly. The administration's five proposals to amend the antitrust laws have now been introduced. In the House, they are H.R. 4247, 4248, 4249, 4250 and 4251. I believe these measures, particularly those to update merger law, hold real promise for business, and I urge your support for them.

One of the administration's bills updates our principal merger statute—section 7 of the Clayton Act. It substitutes for the vague, open-ended language of section 7 a more clearly defined standard that provides specific direction to courts and to businessmen. Mergers will be prohibited if they create a significant probability of market power—that is, the power to hold prices above competitive levels.

That's a simple, straightforward definition that both businessmen and lawyers can understand, as opposed to the vague language now that says the proposed merger, if it "may tend to" create a monopoly, has to be thrown out.

The bill lays out six specific factors which the court must consider in determining whether a given merger will increase a firm's ability to exercise market power. These strictures are still strong enough so that there will not be abuses of the law.

They are:

The effect of the proposed merger on competitors;

The ease or difficulty of entry into the market by any firms that want to do business in that market;

The ability of smaller firms in the market to increase production;

The nature of the product and terms of sale;

The conduct of the firms in the market; and

Efficiencies which would be derived from the merger.

By requiring these factors to be taken into account, our proposal will continue to protect consumers from anticompetitive mergers, but they will give business the certainty it needs to invest in efficiency producing mergers.

Our proposals also include a new remedy under section 201 of the Trade Act of 1974.

Now the President, under section 201, may grant import relief to distressed industries in the form of import quotas or tariff increases. These protectionist measures can be costly to consumers and they can protect inefficient firms.

We want to give the President another option. Mergers within an industry can create more efficient use of capacity and resources. As an alternative to protectionist measures, the President should be able to offer an easing of the merger laws for such an industry. Anticompetitive mergers—please note—would still be illegal. Import competition would continue to provide consumers with low cost goods. The industry's return to competitiveness will be planned and carried out in the boardroom, not in Washington, DC.

The primary purpose of the antitrust laws is to keep American markets competitive. The primary purpose of our trade laws is to keep American markets open. Considered together, they form the best way to protect consumers. The administration's proposals will adjust the antitrust laws to make sure they continue to serve these goals in an era of global competition, by promoting certainty and efficiency.

Mr. Chairman, a number of "naysayers" have said what they think these proposals will do. Let me tell you what they won't do.

Merger reform will not allow anticompetitive mergers. It will not lead to very larger businesses or high levels of industrial concentration. It won't drain financial resources away from more productive uses. It won't repeal the Hart-Scott-Rodino premerger notification procedures. And it won't allow the merger laws to be used to protect competitors or inefficient firms.

That last point deserves repeating.

I'm not proposing merger reform because I think big companies are the answer or because I want to allow anticompetitive mergers. I favor open markets—markets in which purchasers, both business and individual consumers, can choose the lowest priced, best quality materials and goods from anywhere on this globe.

We favor aggressive, fair competition.

We've been moving steadily toward a more open trading system since the end of the Second World War. This commitment is one and the same, with the choice of unrestricted, fair competition over protectionism.

An open market, where competitive forces keep firms efficient and prices lower, is exactly what those who passed our present merger law wanted. In 1950, some people may have thought that required maintaining an industrial structure of mostly small- to medium-sized firms. But today, Mr. Chairman, maintaining small-sized firms may actually require protecting them from competition and not favoring the consumer. And if the competition comes from outside the United States, as it now does, that means retreating from our commitment to open markets—that is, if we try and protect all of our small- and medium-sized companies.

When isolation protected companies from any need to consolidate, we could afford a standard that prevented mergers which posed even a small threat to competition. That's the present Clayton Law where it says where if it "may tend to."

Incidentally, those words, "may tend to," Mr. Chairman, I feel have fed a good many thousand antitrust lawyers and their families for a good number of generations. Their uncertainty is simply too great for businessmen or their lawyers to cope with.

Choosing competition will be hard, in the short run, on American companies and on the work force. But both must adjust. American industry must compete at times against firms favored with lower labor costs and foreign government subsidies. It must rely on its two strengths, ingenuity and flexibility, and it must eliminate unnecessary costs.

Economists have long recognized that mergers can produce more efficient firms. It's like combining two households. The combination needs only one set of managers, one research team, and so forth. They're one way to eliminate duplicative efforts and streamline costs.

Business may certainly choose other alternatives in addition to, or in place of, mergers—productivity, technological or managerial improvements, of course. But that choice should be made by business as to how they can best achieve productivity.

That choice should not be influenced by the uncertainty of how a statute that is no longer literally enforced is going to be interpreted. And if businesses choose to merge, Government should intervene only if the result should harm consumers.

Furthermore, we must not stop a transaction just because it results in a company that may seem large to those who are still living in a small world. We have to stay competitive to stay alive, Mr. Chairman. We only have one way to go.

Finally, there are those who claim our antitrust laws should not be changed because they are the bill of rights for American business. If that's true, let's make sure that these laws provide the basic rights U.S. firms want—freedom to compete, not freedom from competition.

That concludes my remarks, Mr. Chairman. Thank you.

[The prepared statement of Secretary Baldrige follows:]

STATEMENT OF

MALCOLM BALDRIGE

SECRETARY OF COMMERCE

BEFORE THE SUBCOMMITTEE ON ECONOMIC STABILIZATION

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

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MARCH 11, 1986

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I AM PLEASED TO HAVE THE OPPORTUNITY TO DISCUSS THE ISSUE OF U.S. FIRM COMPETITIVENESS WITH THIS COMMITTEE. THE ABILITY OF DOMESTIC FIRMS -- LARGE, MEDIUM AND SMALL -- TO MAINTAIN THEIR COMPETITIVENESS IN THE FACE OF CHANGING ECONOMIC CONDITIONS IS CRITICAL TO OUR ECONOMIC WELL BEING.

THERE WAS A TIME WHEN THE UNITED STATES WAS A CLOSED MARKET, BUT THOSE TIMES ARE GONE, MR. CHAIRMAN. IN THE POST-WAR ERA, THIS COUNTRY HAS PROMOTED, BOTH AT HOME AND AMONG OUR TRADING PARTNERS, THE POLICY OF FREE TRADE. AS A RESULT, WE ARE FACED WITH COMPETITION FROM ALL OVER THE WORLD IN ALMOST EVERY SECTOR OF OUR ECONOMY. OUR ABILITY TO COMPETE IN AN EVER-EXPANDING MARKETPLACE WILL HAVE A PROFOUND EFFECT ON THE LONG-TERM HEALTH OF OUR ECONOMY.

COMPETITION IN THIS COUNTRY USED TO BE NARROWLY DEFINED, MR. CHAIRMAN. BUSINESSMEN COULD EASILY ASSESS THEIR COMPETITOR -- AND

THE ADJUSTMENTS NEEDED BY THEIR FIRMS TO MEET THAT COMPETITION. TODAY, THE SITUATION HAS CHANGED DRAMATICALLY. WE ARE ENCOUNTERING COMPETITION IN NEW AREAS FROM COMPETITORS THAT LITERALLY DID NOT EXIST A FEW YEARS AGO. BASIC MARKET STRUCTURES -- CAPACITY, AND CONCENTRATION, FOR EXAMPLE -- CAN QUICKLY BE REDEFINED BY DECISIONS MADE ABROAD, OFTEN BY FOREIGN GOVERNMENTS FOR WHOM THE BOTTOM LINE IS NOT THE FOREMOST CONCERN.

IN ADDITION, THE FLEXIBILITY OF OUR FIRMS TO MAKE THE NECESSARY ADJUSTMENTS TO THIS CHANGING COMPETITIVE MARKET HAS NARROWED. FOR YEARS, U.S. FIRMS HAVE BEEN PERVASIVELY REGULATED AT BOTH THE FEDERAL AND STATE LEVEL. FOR THE MOST PART, THESE REGULATIONS ARE LEGITIMATE AND IN THE PUBLIC INTEREST. BUT, IN MANY CASES, THEY WERE NOT DEVELOPED WITH THEIR COMPETITIVE IMPACT IN MIND. IN PARTICULAR (AND I WILL EXPAND ON THIS IN A MOMENT), THE ABILITY OF U.S. FIRMS TO COMBINE AND RESTRUCTURE DOMESTICALLY TO MEET NEW COMPETITION FROM ABROAD IS CONSTRAINED BY LAWS AND REGULATIONS THAT WERE DEVELOPED WHEN OUR MARKET WAS CLOSED. JUST AS THE FORM

OF COMPETITION WE EXPERIENCE HAS CHANGED, SO MUST THESE LAWS AND REGULATIONS.

PRESENT SITUATION

MR. CHAIRMAN, THE LAST DECADE HAS SEEN AN EXTRAORDINARY DECLINE IN THE OVERALL COMPETITIVENESS OF AMERICAN BUSINESS. LAST YEAR, WE HAD A MERCHANDISE TRADE DEFICIT OF $148.5 BILLION, ALMOST FOUR TIMES WHAT IT WAS JUST THREE YEARS AGO ($42.7 BILLION), AFTER YEARS OF SURPLUSES. OUR TRADE DEFICIT IN 1986 WILL PROBABLY BE ABOUT AS LARGE AS LAST YEAR. THE IMPACT OF THESE NUMBERS CAN BE BETTER UNDERSTOOD IN TERMS OF LOST OPPORTUNITIES.

IN 1960, TWENTY-EIGHT OF THE WORLD'S THIRTY LARGEST INDUSTRIAL COMPANIES WERE AMERICAN-OWNED AND OPERATED. IN 1986, TWENTY-SIX YEARS LATER, ONLY ELEVEN OUT OF THE TOP THIRTY ARE DOMESTIC FIRMS. THE OTHER NINETEEN ARE FOREIGN-OWNED. THIS SHIFT OF LARGE INDUSTRIAL CAPACITY OFFSHORE REPRESENTS LOST OPPORTUNITIES -- OPPORTUNITIES FOR AMERICAN WORKERS AND CONSUMERS. AND, IT IS ALLOWING

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OUR COMPETITORS ABROAD TO MAKE MAJOR INROADS ON OUR ONCE-DOMINANT COMPETITIVE POSITION.

THE MARKET SHARE ENJOYED BY IMPORTS IN VARIOUS INDUSTRIES IS AN EXAMPLE. IN 1985, OVER 75 PERCENT OF OUR INDUSTRIES EXPERIENCED SOME DEGREE OF IMPORT COMPETITION. IN A FEW INDUSTRIES, THE COMPETITION WAS RELATIVELY SLIGHT. BUT IN MOST SECTORS, FOREIGN COMPETITION WAS SUBSTANTIAL AND GROWING. STEEL IS ONE EXAMPLE WE'VE HEARD A LOT ABOUT. BUT THE SITUATION IS EQUALLY BAD IN A NUMBER OF OTHER INDUSTRIES, INCLUDING:

- RADIO AND TV RECEIVING EQUIPMENT (40 PERCENT IMPORT PENETRATION);
- MOTOR VEHICLES (26 PERCENT PENETRATION);
- LEATHER (33 PERCENT PENETRATION);
- SEMICONDUCTORS (20 PERCENT PENETRATION).

MOST SIGNIFICANTLY, AMONG THE 341 INDUSTRIES NOW ENCOUNTERING IMPORT COMPETITION, IMPORTS TODAY ACCOUNT FOR A SUBSTANTIALLY

GREATER SHARE OF DOMESTIC CONSUMPTION THAN TEN, OR EVEN FIVE, YEARS AGO.

MR. CHAIRMAN, WHILE THE STEADY DECLINE OF THE DOLLAR IS GRATIFYING, ITS EFFECT ON OUR COMPETITIVE ABILITY WILL NOT BITE UNTIL LATER IN THE YEAR. WE CONTINUE TO BUY MORE THAN WE SELL ABROAD, AND FOREIGN ENCROACHMENTS ON OUR DOMESTIC MARKETS CONTINUE TO GROW. WE HAVE A LONG WAY TO GO TO TURN THIS TREND AROUND.

NOW, I THINK WE MAY HAVE NEARLY REACHED THE CORNER ON THE TRADE DEFICIT. I EXPECT THAT THE MONTH-TO-MONTH TREND WILL BE HEADED DOWN BY THE END OF 1986, PARTIALLY AS A RESULT OF THE DOLLAR'S DECLINE, AND WE DEFINITELY SHOULD SEE IMPROVEMENT IN 1987.

BUT I MUST EMPHASIZE THAT OTHER DEVELOPMENTS WILL ALSO BE REQUIRED BEFORE WE BEGIN TO SEE SUBSTANTIAL REDUCTIONS IN OUR TRADE DEFICIT.

THESE INCLUDE: REDUCED FEDERAL SPENDING, FASTER ECONOMIC GROWTH ABROAD, REDUCTION OF UNFAIR TRADE PRACTICES, AND A SUBSTANTIAL EASING OF THE ACUTE FINANCIAL DIFFICULTIES OF SEVERAL HIGH-DEBT LDCS. WE ARE WORKING ON ALL THESE FRONTS, MR. CHAIRMAN, AND WE'RE BEGINNING TO SEE RESULTS.

BUT GOVERNMENT HAS TO PERFORM BETTER IN WHAT I SEE AS ITS BASIC JOB: WE HAVE TO PROVIDE U.S. FIRMS WITH AN ENVIRONMENT IN WHICH THEY CAN BE FREE FROM UNNECESSARY GOVERNMENT REGULATION, AND COMPETE WITHOUT ONE HAND TIED BEHIND THEIR BACKS. WE HAVE TO BE VIGOROUS IN PROTECTING OUR FIRMS FROM UNFAIR FOREIGN TRADING PRACTICES. AND WE HAVE TO FOSTER AN ENVIRONMENT IN WHICH BUSINESS ENJOYS A DEGREE OF ECONOMIC CERTAINTY, WITHOUT BEING WHIPSAWED BY DEVELOPMENTS THAT ARE BEYOND THEIR CONTROL.

IN THIS VEIN, MR. CHAIRMAN, I WANT TO REITERATE OUR SUPPORT FOR THE WORK OF THE PRESIDENT'S COMMISSION ON INDUSTRIAL COMPETITIVENESS. SOME 90% OF THEIR RECOMMENDATIONS EITHER HAVE BEEN DONE OR

ARE UNDER SERIOUS CONSIDERATION. AS I WILL MENTION IN A MOMENT, I PARTICULARLY SUPPORT THE COMMISSION'S RECOMMENDATIONS REGARDING ANTITRUST AND PRODUCT LIABILITY REFORM. I WILL DISCUSS THESE FURTHER IN A MOMENT, BUT LET ME FIRST DISCUSS A FEW OF OUR OTHER INITIATIVES IN THIS AREA.

RECENT ADMINISTRATION ACTIONS

FIRST, MR. CHAIRMAN, REDUCED FEDERAL EXPENDITURES WILL HAVE A SUBSTANTIAL IMPACT ON OUR TRADE DEFICIT BY ASSISTING IN THE FURTHER DECLINE OF THE DOLLARS AND MAKING OUR EXPORTS MORE PRICE-COMPETITIVE. THE PRESIDENT IS COMMITTED TO THE GOAL OF A BALANCED FEDERAL BUDGET. HIS FISCAL YEAR 1987 BUDGET SUBMISSION MEETS THE GRAMM-RUDMAN-HOLLINGS TARGETS FOR NEXT YEAR AND WILL CONTRIBUTE SIGNIFICANTLY TO TURNING OUR TRADE PERFORMANCE AROUND. I URGE YOUR SUPPORT FOR THIS PROPOSAL.

STRIKE FORCE

NEXT, WE ARE VIGOROUSLY PURSUING UNFAIR TRADE PRACTICES WITH OUR

TRADING PARTNERS. THE STRIKE FORCE ON TRADE, ESTABLISHED BY THE PRESIDENT LAST SEPTEMBER AND OF WHICH I AM THE CHAIRMAN, HAS BEEN WORKING HARD TO IDENTIFY SIGNIFICANT UNFAIR TRADE PRACTICES AND PROPOSE ACTIONS TO ELIMINATE THEM, AND THE RESULTS ARE BEGINNING TO SHOW.

WE HAVE SELF-INITIATED AN ANTI-DUMPING INVESTIGATION INTO U.S. SALES OF JAPANESE SEMICONDUCTORS OF 256K DRAMS AND ABOVE. THIS ACTION MARKS THE FIRST TIME THAT THE ADMINISTRATION HAS INITIATED A DUMPING INVESTIGATION (WITH THE EXCEPTION OF CASES RELATED TO THE STEEL TRIGGER PRICE MECHANISM.)

WE ARE GOING INTO CONSULTATIONS IN MARCH WITH FRANCE, GERMANY AND THE U.K. ON THE QUESTION OF THEIR AIRBUS PROGRAM.

WE ARE GOING TO TAKE A SERIES OF STEPS - INCLUDING PROPOSING LEGISLATION - TO STRENGTHEN AND EXPAND PROTECTION OF INTELLECTUAL

PROPERTY RIGHTS, BOTH AT HOME AND ABROAD. IMPROVED PROTECTION FOR U.S. INTELLECTUAL PROPERTY RIGHTS -- PATENTS, COPYRIGHTS AND TRADEMARKS -- IS ESSENTIAL. THIS PROBLEM COSTS U.S. BUSINESS AN ESTIMATED $8-20 BILLION ANNUALLY IN LOST SALES AT HOME AND ABROAD. COUNTERFEITING AND PIRACY ALSO RESULT IN LOST U.S. JOBS, HEALTH AND SAFETY CONCERNS AND A DIMINISHED REPUTATION FOR U.S. GOODS.

MR. CHAIRMAN, I'VE DISCUSSED EXAMPLES OF LEGITIMATE GOVERNMENT STEPS WE ARE TAKING THAT WILL HAVE AN EFFECT ON U.S. FIRMS' COMPETITIVE AND ARE FULLY CONSISTENT WITH THE PRESIDENT'S POLICY OF FREE AND FAIR TRADE. BUT THERE ARE OTHER MAJOR DOMESTIC ACTIONS, NOT DIRECTLY RELATED TO TRADE, THAT CAN FOSTER COMPETITIVENESS WHILE KEEPING MARKETS OPEN.

PRODUCT LIABILITY REFORM

TODAY, MR. CHAIRMAN, AMERICAN BUSINESSES ARE FINDING THEMSELVES IN THE MIDDLE OF A PRODUCT LIABILITY INSURANCE CRISIS. A MAJOR FACTOR CONTRIBUTING TO THIS CRISIS IS THE UNCERTAINTY AND

INSTABILITY IN OUR PRODUCT LIABILITY SYSTEM. THIS UNCERTAINTY HAS AN ADVERSE EFFECT ON OUR PRODUCTIVITY AND INTERNATIONAL COMPETITIVENESS. REFORM OF THE SYSTEM IS NEEDED, AND WE ARE GIVING THIS HIGH PRIORITY. IN HIS FOLLOW-ON MESSAGE TO THE STATE OF THE UNION ADDRESS, THE PRESIDENT SAID THAT THE ADMINISTRATION WILL CONTINUE TO WORK TOWARD "A UNIFORM STANDARD OF PRODUCT LIABILITY THAT IS FAIR TO CONSUMERS AND MANUFACTURERS ALIKE." WE INTEND TO WORK WITH THE CONGRESS AND ALL INTERESTED PARTIES TOWARD BRINGING ABOUT MEANINGFUL REFORM.

TECHNOLOGY AND PRODUCTIVITY

MR. CHAIRMAN, TECHNOLOGY IS ONE OF THE FEW AREAS WHERE WE STILL HAVE AN ADVANTAGE OVER OUR COMPETITORS. ONE OF OUR BEST HOPES FOR IMPROVING OUR TRADE PERFORMANCE IS BETTER USE OF TECHNOLOGY FOR INCREASING INDUSTRIAL PRODUCTIVITY. THE NATIONAL BUREAU OF STANDARDS, WITHIN MY DEPARTMENT, IS WORKING WITH A NUMBER OF INDUSTRIES TO INCREASE PRODUCTIVITY. NBS' WORK WITH THE STEEL INDUSTRY TO APPLY HIGH TECHNOLOGY MEASUREMENT METHODS IN STEEL

PROCESSING, FOR EXAMPLE, COULD RESULT IN PRODUCTIVITY IMPROVEMENTS AND ENERGY SAVINGS VALUED AT ABOUT $275 MILLION ANNUALLY. NBS' INITIATIVE TO DEVELOP THE MEASUREMENT AND STANDARDS BASE FOR ADVANCED CERAMICS MAY ALLOW U.S. SHIPMENTS OF ADVANCED CERAMIC PRODUCTS TO GROW MORE THAN FIVEFOLD BY THE END OF THE CENTURY. WE THINK THESE SHIPMENTS COULD REACH $10 BILLION ANNUALLY .

ANTITRUST REFORM

THERE IS ONE CONTRIBUTION TO AMERICAN COMPETITIVENESS WHICH WE CAN ACHIEVE RELATIVELY QUICKLY. THE ADMINISTRATION'S FIVE PROPOSALS TO AMEND THE ANTITRUST LAWS HAVE NOW BEEN INTRODUCED. IN THE HOUSE, THESE ARE H.R. 4247, H.R. 4248, H.R. 4249, H.R. 4250 AND H.R. 4251. I BELIEVE THESE MEASURES, PARTICULARLY THOSE TO UPDATE MERGER LAW, HOLD REAL PROMISE FOR BUSINESS, AND I URGE YOUR SUPPORT FOR THEM.

ONE OF THE ADMINISTRATION'S BILLS UPDATES OUR PRINCIPAL MERGER STATUTE -- SECTION 7 OF THE CLAYTON ACT. IT SUBSTITUTES FOR THE VAGUE, OPEN-ENDED LANGUAGE OF SECTION 7 A MORE CLEARLY DEFINED

STANDARD THAT PROVIDES SPECIFIC DIRECTION TO COURTS AND BUSINESSMEN. MERGERS WILL BE PROHIBITED IF THEY CREATE A SIGNIFICANT PROBABILITY OF MARKET POWER -- THAT IS, THE POWER TO HOLD PRICES ABOVE COMPETITIVE LEVELS. THE BILL LAYS OUT SIX SPECIFIC FACTORS WHICH THE COURTS MUST CONSIDER IN DETERMINING WHETHER A GIVEN MERGER WILL INCREASE A FIRM'S ABILITY TO EXERCISE MARKET POWER. THESE ARE -

(1) THE EFFECT OF THE PROPOSED MERGER ON COMPETITORS;

(2) THE EASE OR DIFFICULTY OF ENTRY INTO THE MARKET BY ANY FIRMS THAT WANT TO DO BUSINESS IN THAT MARKET;

(3) THE ABILITY OF SMALLER FIRMS IN THE MARKET TO INCREASE PRODUCTION;

(4) THE NATURE OF THE PRODUCT AND TERMS OF SALE;

(5) THE CONDUCT OF FIRMS IN THE MARKET; AND

(6) EFFICIENCIES WHICH WOULD BE DERIVED FROM THE MERGER.

BY REQUIRING THESE FACTORS TO BE TAKEN INTO ACCOUNT, OUR PROPOSAL WILL CONTINUE TO PROTECT CONSUMERS FROM ANTICOMPETITIVE MERGERS,

BUT THEY WILL GIVE BUSINESS THE CERTAINTY IT NEEDS TO INVEST IN EFFICIENCY-PRODUCING MERGERS.

OUR PROPOSALS ALSO INCLUDE A NEW REMEDY UNDER SECTION 201 OF THE TRADE ACT OF 1974.

UNDER SECTION 201, THE PRESIDENT MAY GRANT IMPORT RELIEF TO DISTRESSED INDUSTRIES IN THE FORM OF IMPORT QUOTAS OR TARIFF INCREASES. THESE PROTECTIONIST MEASURES CAN BE COSTLY TO CONSUMERS AND CAN PROTECT INEFFICIENT FIRMS. WE WANT TO GIVE THE PRESIDENT ANOTHER OPTION. MERGERS WITHIN AN INDUSTRY CAN CREATE MORE EFFICIENT USE OF CAPACITY AND RESOURCES. AS AN ALTERNATIVE TO PROTECTIONIST MEASURES, THE PRESIDENT SHOULD BE ABLE TO OFFER AN EASING OF THE MERGER LAWS FOR SUCH AN INDUSTRY. ANTICOMPETITIVE MERGERS WILL STILL BE ILLEGAL. IMPORT COMPETITION WILL CONTINUE TO PROVIDE CONSUMERS WITH LOW COST GOODS. THE INDUSTRY'S RETURN TO COMPETITIVENESS WILL BE PLANNED AND CARRIED OUT IN THE BOARDROOM, NOT IN WASHINGTON.

THE PRIMARY PURPOSE OF THE ANTITRUST LAWS IS TO KEEP AMERICAN MARKETS COMPETITIVE. THE PRIMARY PURPOSE OF OUR TRADE LAWS IS TO KEEP AMERICAN MARKETS OPEN. CONSIDERED TOGETHER, THEY FORM THE BEST WAY TO PROTECT CONSUMERS. THE ADMINISTRATION'S PROPOSALS WILL ADJUST THE ANTITRUST LAWS TO MAKE SURE THEY CONTINUE TO SERVE THESE GOALS IN AN ERA OF GLOBAL COMPETITION, BY PROMOTING CERTAINTY AND EFFICIENCY.

MR. CHAIRMAN, A NUMBER OF "NAYSAYERS" HAVE SAID WHAT THEY THINK THESE PROPOSALS WILL DO. LET ME TELL YOU WHAT THEY WILL NOT DO.

MERGER REFORM WILL NOT ALLOW ANTICOMPETITIVE MERGERS. IT WILL NOT LEAD TO VERY LARGE BUSINESSES OR HIGH LEVELS OF INDUSTRIAL CONCENTRATION. IT WON'T DRAIN FINANCIAL RESOURCES AWAY FROM MORE PRODUCTIVE USES. IT WON'T REPEAL THE HART-SCOTT-RODINO PREMERGER NOTIFICATION PROCEDURES. AND IT WON'T ALLOW THE MERGER LAWS TO BE USED TO PROTECT COMPETITORS OR INEFFICIENT FIRMS.

MR. CHAIRMAN, THAT LAST POINT DESERVES REPEATING. I AM NOT PROPOSING MERGER REFORM BECAUSE I THINK BIG COMPANIES ARE THE ANSWER OR BECAUSE I WANT TO ALLOW ANTICOMPETITIVE MERGERS. I FAVOR OPEN MARKETS - MARKETS IN WHICH PURCHASERS, BOTH BUSINESS AND INDIVIDUAL CONSUMERS, CAN CHOOSE THE LOWEST-PRICED, BEST-QUALITY MATERIALS AND GOODS FROM ANYWHERE ON THIS GLOBE. I FAVOR AGGRESSIVE, FAIR COMPETITION.

WE HAVE BEEN MOVING STEADILY TOWARDS A MORE OPEN TRADING SYSTEM SINCE THE END OF THE SECOND WORLD WAR. THIS COMMITMENT IS ONE AND THE SAME WITH THE CHOICE OF UNRESTRICTED, FAIR COMPETITION OVER PROTECTIONISM.

AN OPEN MARKET, WHERE COMPETITIVE FORCES KEEP FIRMS EFFICIENT AND PRICES LOWER, IS EXACTLY WHAT THOSE WHO PASSED OUR PRESENT MERGER LAW WANTED. IN 1950, SOME PEOPLE MAY HAVE THOUGHT THAT REQUIRED MAINTAINING AN INDUSTRIAL STRUCTURE OF SMALL FIRMS. BUT TODAY, MR. CHAIRMAN, MAINTAINING SMALL- TO MEDIUM-SIZED FIRMS MAY

ACTUALLY REQUIRE PROTECTING THEM FROM COMPETITION. AND, IF THE COMPETITION COMES FROM OUTSIDE THE UNITED STATES, AS IT NOW DOES, THAT MEANS RETREATING FROM OUR COMMITMENT TO OPEN MARKETS.

WHEN ISOLATION PROTECTED COMPANIES FROM ANY NEED TO CONSOLIDATE, WE COULD AFFORD A STANDARD THAT PREVENTED MERGERS WHICH POSED EVEN A SMALL THREAT TO COMPETITION. THE ONLY WAY TO JUSTIFY THIS STRICT STANDARD NOW IS TO SUPPORT A RETURN TO ECONOMIC ISOLATIONISM. THE CHOICE IS THAT SIMPLE.

CHOOSING COMPETITION WILL BE HARD, IN THE SHORT RUN, ON AMERICAN COMPANIES AND ON THE WORK FORCE. BOTH MUST ADJUST. AMERICAN INDUSTRY MUST COMPETE AT TIMES AGAINST FIRMS FAVORED WITH LOWER LABOR COSTS AND FOREIGN GOVERNMENT SUBSIDIES. IT MUST RELY ON ITS TWO STRENGTHS, INGENUITY AND FLEXIBILITY, AND IT MUST ELIMINATE UNNECESSARY COSTS.

ECONOMISTS HAVE LONG RECOGNIZED THAT MERGERS CAN PRODUCE MORE EFFICIENT FIRMS. IT'S LIKE COMBINING TWO HOUSEHOLDS. THE COMBINATION NEEDS ONLY ONE SET OF MANAGERS, ONE RESEARCH TEAM. MERGERS ARE ONE WAY TO ELIMINATE DUPLICATIVE EFFORTS AND STREAMLINE COSTS. BUSINESS MAY CERTAINLY CHOOSE OTHER ALTERNATIVES IN ADDITION TO, OR IN PLACE OF, MERGERS: FOR EXAMPLE, PRODUCTIVITY, TECHNOLOGICAL OR MANAGERIAL IMPROVEMENTS. BUT, THE CHOICE MUST BE MADE BY BUSINESS. THAT CHOICE SHOULD NOT BE INFLUENCED BY THE UNCERTAINTY OF HOW A STATUTE THAT IS NO LONGER LITERALLY ENFORCED IS GOING TO BE INTERPRETED. AND IF BUSINESSES CHOOSE TO MERGE, GOVERNMENT SHOULD INTERVENE ONLY IF THE RESULT WILL HARM CONSUMERS. FURTHERMORE, WE MUST NOT STOP A TRANSACTION JUST BECAUSE IT RESULTS IN A COMPANY THAT MAY SEEM LARGE TO THOSE WHO ARE STILL LIVING IN A SMALL WORLD. WE HAVE TO STAY COMPETITIVE TO STAY ALIVE, MR. CHAIRMAN. THAT'S THE ONLY WAY TO GO.

FINALLY, MR. CHAIRMAN, THERE ARE THOSE WHO CLAIM OUR ANTITRUST LAWS SHOULD NOT BE CHANGED BECAUSE THEY ARE THE "BILL OF RIGHTS" FOR AMERICAN BUSINESS. IF THAT IS TRUE, LET'S MAKE SURE THESE LAWS PROVIDE THE BASIC RIGHTS U.S. FIRMS WANT -- FREEDOM TO COMPETE, NOT FREEDOM FROM COMPETITION.

MR. CHAIRMAN, THAT CONCLUDES MY PREPARED REMARKS.

Chairman LAFALCE. Thank you very much, Secretary Baldrige.

I have heard from a great many individuals over the years, primarily the business community, of the need to change our antitrust laws in order to enhance our competitiveness. And I am very open to persuasion to that point of view. I'm certainly not bound against changing our antitrust laws.

As you know, I was the original sponsor of the Export Trading Company legislation, which, indeed, changed our antitrust laws with respect to export trading companies.

However, with respect to the type of mergers that you're talking about here, I do have some felt difficulties. Based just upon my general exposure to the problem, I can't think of very many instances, if any, within the last 10 years, in which the courts have prohibited what one might call a procompetitive merger.

If you can, I'd like you to share that information with me. And also, it seems to me that there are an awful lot of mergers taking place, perhaps a record high number. As a matter of fact, I believe that within the Reagan administration, 1985 was a record year for mergers—34 of which involved sales prices of at least $1 billion, and all of which involved almost $200 billion worth of mergers.

I'm advised that since President Reagan took office, only 26 of over 10,000 mergers have even been challenged.

And so I'm wondering what the evidence is to support the proposition that our antitrust laws have, indeed, halted any proposed procompetitive merger.

Mr. BALDRIGE. Mr. Chairman, first, I have to differ with you on the number of mergers or the fact that we're in some kind of merger mania.

In 1985—these are Justice Department figures—in 1985, there were 3,000 acquisitions. Justice defines that term very broadly.

Using the same——

Chairman LAFALCE. I said 10,000 over the term of the Reagan administration, not in 1985.

Mr. BALDRIGE. But in 1985, which was the highest year, there were 3,000 mergers or acquisitions, in the broadest sense of the term. And using that same broad sense, in 1968, which is not going back too far, there were double that. There were 6,000.

In every year between 1968 and 1984, there were more mergers than there were in 1985.

Chairman LAFALCE. When we talk about a merger, we can talk of a merger between a mom and pop store and a brother and sister store. Maybe that's what took place way back when. But lately, it seems to me, we've been having these multibillion dollar mergers.

Mr. BALDRIGE. Yes, but I think——

Chairman LAFALCE. To the tune, as I said, of almost $200 billion in 1985.

In any event, my question is what mergers have been prohibited that would have been procompetitive on account of our antitrust laws?

Mr. BALDRIGE. All right. Let me get to that, Mr. Chairman, but I still would like to answer the first part of your statement or question.

There hasn't been a merger mania. There have been other years, as many as five or six, when there have been more mergers. The

total dollar amount in each of those years I don't have, but, obviously, business, on a global scale, is getting bigger and you would expect the dollars to get bigger.

That's the first point.

The second point is, when people say, with some puzzlement, well, aren't the merger laws all right now? Look at the mergers that have taken place. We're talking about horizontal mergers here, procompetitive mergers, where companies in the same field, more or less, that have been prevented or are afraid to even try to merge because of what would happen under the antitrust laws.

Under no administration I know of, would the Justice Department have challenged the bulk of these large mergers we've seen lately because they're conglomerate mergers. They're among companies that have no large or even medium-sized compatibilities, as far as product line goes. So that they're not subject, really, to the same kind of antitrust scrutiny. And that's what's been happening. That's been the trend.

Now, have there been any stopped?

This point is one of the most important points I could make, Mr. Chairman. It's often overlooked. It's difficult for lawyers and Congressmen and Senators to put themselves in the place of businessmen.

Businessmen abhor uncertainty. They can't take the expense or the publicity, particularly if they're the one being acquired or the smaller part of the merger, of announcing something, having to spend all kinds of money to defend it if there's a suit, and then having to back off at the last minute.

There are literally hundreds of mergers that never get out of the chute, that never happen, because of the uncertainties of our trade law.

I've been in some of those myself on several boards of directors and I've seen it first hand. You have no idea of the fear that businessmen have of what will happen in the antitrust department when we have laws that say, if a proposed merger "may tend to." They simply don't go about it.

Chairman LAFALCE. Mr. Secretary, I remember, shortly after I got back from a trip to Japan with the American Productivity Center in the fall of 1981, and we got together with a group of top-notch individuals to discuss antitrust laws. It was a private meeting over at someone's home. We had Nick Katzenbach. We had Bill Baxter, et cetera.

Mr. BALDRIGE. Well, I know what Bill Baxter would say right now.

Chairman LAFALCE. Yes, I know what Bill Baxter said, too. [Laughter.]

He said there's not a thing that these people want to do that would be prohibited by our antitrust laws. I don't know why they have this unbelievable——

Mr. BALDRIGE. All right. Well, let me tell you my answer to Bill Baxter right there. He doesn't——

Chairman LAFALCE. He was viewed as the largest proponent of mergers that you could find. That's why President Reagan brought him in as his first assistant attorney general for antitrust. Not because he was going to be stringent in interpreting the antitrust

laws, but because he was going to be very liberal in interpreting the antitrust laws and allow mergers to take place.

Mr. BALDRIGE. Well, Mr. Baxter is on record as saying quite a few things on this subject, one of which was that Secretary Baldrige didn't know what he was talking about. [Laughter.]

But the others—I will give you this answer, and Bill Baxter doesn't have an answer to this, a comeback.

That is, we have seen the Justice Department guidelines modified, eased. There's no question about it. Those, however, Mr. Chairman, are prosecutorial Justice Department guidelines. They do not affect the courts. They do not affect the plaintiffs, the parties who bring antitrust suits, sometimes for nuisance reasons, sometimes for well-meant reasons. But they are not part of our law.

And we have seen two Federal judges come up and say that: "I am not going to go by the Justice Department prosecutorial guidelines. My job is to interpret Clayton and Sherman, if it happens to come under that. The plaintiffs can bring a suit under that."

So if you add those two facts to the proposition that the next administration can always change the guidelines, then you have an uncertainty that clearly bothers businessmen, because it's not part of the law.

What we're saying is let's codify those guidelines and put them in the law and make it——

Chairman LAFALCE. OK. My first question is do you codify the guidelines, or do you go above and beyond the guidelines insofar as your proposed bills are concerned?

Mr. BALDRIGE. I would say that these are very close to the guidelines. What we may go above and beyond is in the language that everybody can understand. Instead of saying if this merger may tend to, we say, does it have a significant probability of, and then we define what that——

Chairman LAFALCE. Yes, but there's a big difference between "may tend to" and "have a significant probability."

Mr. BALDRIGE. Yes. But Justice——

Chairman LAFALCE. And it seems to me that that goes way beyond the guidelines.

Mr. BALDRIGE. But you asked me, does this change beyond the guidelines? The guidelines are being interpreted now more toward the language of "have a significant probability" than they are "may tend to." That's very clear, that they have tended that way, and that's been the result in practice.

Mr. Chairman, I'd like to make one point on that last question. For the life of me, I can't see anything wrong with making this understandable to both businessmen and lawyers.

If we say, the proposed merger has a significant probability of being able—of merged companies being able to raise prices above the market level for a significant period of time, it should not be allowed.

Now that's something that I think everyone could agree on. So why not put it in the law.

Chairman LAFALCE. My time has expired.

Congressman Shumway.

Mr. SHUMWAY. Thank you, Mr. Chairman.

Mr. Secretary, this package of amendments that you have brought forward and described today, is it based either fully or partially upon Japanese law? In other words, to seize some of the competitive advantage, are we copying the Japanese or have they exerted any influence on these proposed changes?

Mr. BALDRIGE. We'd have a long way to go to copy the Japanese.

Mr. SHUMWAY. I know there are many areas that we would not copy them in. But in this regard, with reference to these antitrust amendments are we attempting to emulate their practices?

Mr. BALDRIGE. No, I would say in no way. The Japanese allow mergers when MITI feels it's in the interest of the government, the Japanese people. They force feed merger participants, grow them up by force feeding. They allow industries that are in a depressed situation. They allow import barriers of one kind or another that we don't allow.

The whole way they look at law is completely different. There, the businessmen and the government view themselves as one. They're trying to help each other. Here, we've grown up a different way. We feel that the systems of checks and balances is a better way.

This is not a copy of the Japanese system in any way.

Mr. SHUMWAY. But in many of our discussions about this great trade imbalance that we've had with Japan, we keep seeking some degree of parity. If the Japanese have nontariff trade barriers, then we should have them. If they have loose antitrust laws, we should have them.

Mr. BALDRIGE. No, sir. I would characterize that as completely wrong, if I can say it politely.

We want open markets. We don't want barriers. That's what the administration has been fighting for. Even when we use the 301 cases where we're beginning to take tougher action, they're only to open up markets abroad.

Mr. SHUMWAY. I'm not attributing those remarks to the administration. We hear them on Capitol Hill here from various sectors.

Mr. BALDRIGE. In loosening the laws, I think, in effect, we're going along with mostly what the present situation is now, but we're making it clear enough so that everybody can understand it.

Why be afraid of saying, if there's a significant probability that this merger can raise prices above a competitive level? That's what we're worried about. Why not make it plain enough for people to understand?

Mr. SHUMWAY. Now in your spoken statement here this morning, Mr. Secretary, you didn't say this, but I understand in the administration's proposal, with reference to the amendments for section 201 of the Trade Act, that the proposal says that if an industry can show that it's been injured by foreign competition, it can receive a 5-year grant of immunity from the antitrust laws in lieu of quotas or other relief.

Is that so or not?

Mr. BALDRIGE. No, sir; that's an overstatement. First, the injury has to be decided by the International Trade Commission. The ITC has to have a ruling that the industry is, in fact, injured. No. 1.

Right now, the President has two choices if that finding is made. He can either say to the industry, I will protect you, which raises

cost to consumers and so forth, or I won't protect you, which leaves the industry still injured and is not much of an answer to it.

We want to give him a third option. If he doesn't want to use either one of those first two, relax—not do away with, but relax—the antitrust laws in that area so that under Clayton 7, for example, you would just look at the effect of any proposed merger in the industry as to what that merger would do. And if it would not raise prices above the competitive level, or have the ability to do that, it can go through.

So it relaxes, it doesn't remove, the antitrust strictures.

Mr. SHUMWAY. What happens after that period of relaxation? Any mergers that have occurred during that time, are they going to be undone or——

Mr. BALDRIGE. Five years. For 5 years, you can merge to restructure. There are so many industries that are in difficulty because they have outmoded plants along with some good ones, businesses are hurting them, draining them, that in a merger, you can build on your strengths and are better able to get rid of your weaknesses.

We urge the Europeans to do that so that they don't subsidize. We don't subsidize; the Europeans do.

In steel, for example, we found subsidies at 20 to 30 percent. We urge the Europeans to restructure, shut down some of their inefficient excess capacity and then they wouldn't have to subsidize and we could take our duties off, countervailing duties.

We go around the world telling other nations to restructure their industries and then we make it tough in cases where, clearly, the imports have been affected. The steel case is one—the steel industry is one.

Mr. SHUMWAY. So if a merger has occurred during that 5 years or period of relaxation, after relaxation we get back to strict adherence of the law. That merger stays in place.

Mr. BALDRIGE. Yes.

Mr. SHUMWAY. OK.

Mr. BALDRIGE. But that merger also is obviously subject to Sherman or anything else.

Let's suppose that, for some unknown reason, everything just switched around. So all of a sudden, there were some antitrust violations actually going on as a result of this merger. There's still Sherman to get after them with.

Mr. SHUMWAY. All right. Thank you, Mr. Secretary.

Chairman LAFALCE. Mr. Levin.

Mr. LEVIN. Mr. Secretary, if you had to put antitrust policy on a scale with other problems and factors that you've mentioned in terms of the trade deficit, where would you place it?

Mr. BALDRIGE. I'd have to make a guess, Mr. Congressman. This isn't scientific, just a personal observation.

Mr. LEVIN. Right.

Mr. BALDRIGE. Of the 10 leading steps we ought to take, this would be 7th or 8th. It wouldn't be first. Mergers—relaxation or changing of Clayton 7, we have said time and again, is not going to just take our trade deficit away. It's part of the overall competitiveness mosaic that we ought to put in place. It's a help. It's not going to solve all our problems; it's just going to help in some cases.

Mr. LEVIN. So out of a list of 10, it would rank toward the bottom.

Mr. BALDRIGE. Yes. I would say that it would rank in the last five, the bottom half. That's compared to the dollar, to having developing countries adopt policies that get them out of their debt problems, to have the Europeans and the Japanese stimulate their growth.

Those are more important right now than antitrust is. But we've never claimed anything else but what I've just said for antitrust. We haven't said this is a panacea; it's a help.

Mr. LEVIN. Let me ask you about one industry that a number of us have been working in, and this has perhaps been brought directly to your attention. It relates to motor vehicles and equipment and the trade imbalance with Japan. About half of the trade deficit with Japan—that's about $50 billion at the moment—about half of it is in motor vehicles and equipment.

Take any or all of the proposals, antitrust proposals that you forwarded. What kind of an impact, if any, would those changes have on that deficit? And if you could give me some possible specifics.

Mr. BALDRIGE. You mean what the Japanese——

Mr. LEVIN. Our large automobile, motor vehicle and motor vehicle equipment deficit with Japan, it's about half of the $50 billion trade deficit with Japan. Just how might this impact on that trade deficit?

Mr. BALDRIGE. Well, that's almost impossible to answer with any kind of a specific or scientific set of numbers.

I can give you some specific examples that I think Chairman LaFalce asked me for and when I got to talking too long, I didn't give him, that happen to apply to Europe in this case, but they could just as well apply to Japan.

You mentioned the automotive industry and so forth. In our heavy trucking industry, there are about six or seven companies—GM, Ford, Paccar out on the west coast, Freightliner, Mack, and White and Harvester—plenty of competition, all of them good companies.

Mack and White and Freightliner, in the late 1970's or 1980, all decided to put enough research and development money in, but for them to keep their position they had to merge. Paccar wanted to buy them. Paccar's Washington lawyers and their lawyers in-house both said, there is no way you'll be allowed to buy Freightliner or Mack or White.

So they backed away from three potential deals there.

Here's what happened. Freightliner was sold to Daimler Benz, the largest truck manufacturer in the world. Daimler Benz was given an immediate entree into this market that's going to hurt our competitive position.

Mack truck—Paccar couldn't buy them. Paccar was advised by counsel of that. So Mack went to Renault, the second largest truck manufacturer in the world, and is now associated with them.

White, the same thing, and they went to Volvo.

Now that's what our antitrust laws have been doing, Mr. Congressman. They've been in too many cases driving U.S. companies into the control of large foreign countries, and there's no way our laws meant to do that in the first place.

Mr. LEVIN. Of course, under your changes, there's no guarantee that that kind of a merger with a foreign company would not happen anyway, right?

Mr. BALDRIGE. I think that under the changes we've proposed, and I have to speak as a layman here, but I do not think that with GM and Ford and those foreign companies able to come over here, that Packar, which had 18 percent of the market—I think they would have been able to buy one of those other companies, and perhaps the other two could have merged themselves. I don't know.

But that's my belief, because there's some very strong interest in that market.

And let me say, Mr. Congressman, that goes beyond just that first ripple. Cummins Engine is one of the two largest diesel manufacturers in the United States, a midwestern company. They had, and had won through fair competition, all of the business in those four companies. Once they got sold out, 50 percent of it went abroad to the Europeans, who now own the companies. And Cummins Engine, as a supplier, the point you're bringing up, has just lost half of that diesel engine business that they used to enjoy with those companies.

Mr. LEVIN. All right. Those are interesting examples and I hope we'll have a chance, perhaps with the help of the staff, to look at those.

Let me mention, your testimony refers to other obstacles to trade and reducing the trade deficit. And you put this set of antitrust proposed changes toward the bottom.

A number of us have sent a letter to you relating to the automobile, the motor vehicle and supply industry and especially relationships with Japan, urging that this area be placed within the context of the MOSS talks to try to get at some of the disparate and unfair trade practices.

As you know, the Japanese companies sell over $13 billion worth of cars produced there in this market every year, or in the last year, and American companies have been able to sell only about $100 million worth of auto parts for that production over there.

I don't believe we've heard back yet from you and I would hope that you could take the lead within the administration to place this critical area within the MOSS talks structure. Otherwise, I'm afraid that no matter what other proposals are presented, not much progress is going to be made. And certainly, antitrust changes are not going to, I think you would acknowledge, make a real dent in the terrible imbalance between Japan and the United States in the motor vehicle and parts area.

Mr. BALDRIGE. No, I can't say how big a dent, Mr. Congressman. I'm not denigrating in any way what could be the beneficial effects of antitrust changes when I say that there are five more important problems. I mean, I'm just trying to be honest about that.

What happens abroad as far as market openings and the size of their market is more important than antitrust. But at the same time, we don't want to provide all these remedies sequentially and wait until all ten get solved before we move to antitrust. I think we ought to move across the front.

In direct answer to your question, we are identifying at the Commerce Department, partially as a result of your letter, for certain,

all the Japanese Government barriers to U.S. auto parts. We will then seek their removal through negotiations.

In particular, we're going to go after the nonoriginal equipment market, which is presently, from all practical purposes, closed to us. If we don't get their removal, I will be working to raise that at the MOSS talks. But we'll try it on just regular negotiations first.

They made some promises to us a few years back that they didn't keep on auto parts. We look on this as a very important area.

Mr. LEVIN. Thank you, Mr. Chairman.

Chairman LAFALCE. The time of the gentleman has expired.

Mr. LEVIN. Thank you.

Chairman LAFALCE. Secretary Baldrige has to leave no later than 20 after 12 and, therefore, we'll have to be extremely strict now in our observance of the 5-minute rule.

Mr. McKinney.

Mr. MCKINNEY. Mr. Secretary, I am delighted that you're showing that chart around. It certainly is a wonderful chart. It's beautiful—we have General Motors, Ford, IBM, General Electric, Chrysler, United Technologies, IT&T—all of which are on the list as still major corporate entities in this world.

I would love to see another chart come out of Commerce that would show us the onshore production of these companies and where it was 20-odd years ago and where it is today because I think many times we get carried away with the fact that they're growing and forget that they are moving offshore. Please don't get mad at me but for instance, IBM is everywhere and IBM's production is shifting more and more and more inexorably offshore.

You know, it's funny. I brought up Lee Iacocca and the Chrysler Corp. earlier in my opening statement. You can't live through a situation like that and not have it become a part of you. We waxed poetic for weeks and months. The chairman was part of our negotiations over signing a loan guarantee for $1.5 billion, which was repaid ahead of time with interest. The U.S. Treasury made $735 million on that package. But at the time you would have thought we were giving away the U.S. Treasury. And yet, prospectively, none of our auto manufacturers of the big group thought they could get together, for instance, over pollution controls and government regulation because Clayton would slam on their tents.

Of course, it was all right to exempt American Motors Corp. in the other body and it's all right to buy this, that, and the other thing, after the fact.

So I said to Mr. Iacocca, and it's the first time I've ever seen Lee silent on the subject—where would you be today, and Chrysler, if you hadn't had to spend the over $3 billion you spent on government regulations? I think we all know the answer. Whereas, in fact, the Japanese met in one big, happy halycon meeting and stated that, oh, this is wonderful. This is the way we sell cars that don't pollute the atmosphere. Let's all get together and let's produce this catalytic converter and let's put it in every single darn automobile.

One of the points that I think you stressed and needs such incredible stressing, I'd say, Mr. Chairman, is that the fear of Clayton is prospective rather than retroactive.

Mr. BALDRIGE. Absolutely.

Mr. MCKINNEY. And you can't say that enough. I have been to too many meetings in steel, automobiles and everything else. I understand the gentleman's frustration from Michigan, that we set up this prospective fog bank—oh, God, there comes Clayton. In the meantime, Mr. James Goldsmith and Mr. Ichan and the rest of them are making merry with the rest of the economy in mergers but they are, in fact, mergers of multitudinous companies all making different things.

I just wanted to reemphasize that.

You're essentially proposing rewriting section 7 of the Clayton antitrust law; right?

Mr. BALDRIGE. No, honestly, Mr. Congressman, we're not. Clayton 7 is there. We want to amend principally that phraseology I mentioned. Instead of saying "may tend to," which, as I said, has provided employment, happily, for thousands of lawyers over the years—what does "may tend to" mean? A businessman can't figure it out. This Paccar CEO, his lawyers said, well, like this, so he didn't go ahead with those, which would have been very competitive mergers or procompetitive mergers.

Why not say a significant probability? What's wrong with that? If you're wrong and the significant probability that they won't be able to fix prices and so forth, if they do, you've still got Sherman to get after them with. But why put handcuffs on our businesses? That's my point, that it would not be that major change in rewriting the whole thing. It's just changing that language.

Mr. MCKINNEY. Well, you have a large red American Mercury sitting out there with 40 percent foreign parts in it. It's going to whisk you away from here.

Mr. Chairman, I have a problem and I haven't been able to participate as much as——

Chairman LAFALCE. Just one? [Laughter.]

Mr. MCKINNEY. We, as a nation, come up with a public policy concern, be it OSHA, be it pollution. I don't want anything in that area to change. But we have no realization that those are competitive factors, and that's what you're, in essence, saying, and I'm on your side.

I'm not sure big is better. I look at Fairfield County, CT, and I'm in horror at some of the mergers that I have seen taking place in some of the takeovers, friendly or unfriendly.

But the fact of the matter is, Mr. Chairman, that the most valuable thing that can come out of these hearings is the fact that national public policy is a competitive factor for American industry to do business in the world. And it has got to be realized that along with the national policy that we're not going to pollute, we need to let our companies get together to do what they have to do to make this a better world. We have to let them work efficiently so that we can compete with other people who don't seem to care one way or the other and who seem to love to steal our free market.

If, in fact, we don't react this way, Mr. Chairman, this Congress is going to close the free market. And that's coming from a Republican.

Chairman LAFALCE. One of these days, we'll wake up to the fact that the cries for an industrial competitiveness strategy are primarily designed to offer an alternative to protectionism.

Mr. BALDRIGE. Yes. That's exactly the point, Mr. Chairman. If we don't take some of these moves—for instance, under 201, the alternative is protectionism.

Chairman LAFALCE. Right. Well, we have to take moves. The question is, what moves, and whether or not it's necessary to revise the antitrust laws in order to become more competitive.

Mr. McKinney said something that was quite telling. He sees some mergers taking place up around Connecticut that horrify him. I've seen some mergers take place around New York State, western New York, the United States—I don't want to say that they've horrified me, but it's difficult for me to see how they've enhanced efficiency or productivity. It is easy for me to see how they have resulted in a devastating impact on certain local communities without any national community adjustment assistance program to help either the communities or the individuals adversely affected.

It also is easy for me to observe how these mergers have led to a tremendous amount of outsourcing or overseas development. These are some of the difficulties that we're going to have to overcome to be successful in amending the antitrust law.

Mr. BALDRIGE. Sir, if I could make the point that the kinds of mergers that have you and Congressman McKinney bothered, are not these kinds of mergers. You're talking about conglomerate mergers—two large companies without much in common buying each other out just to get larger.

We're talking here solely about procompetitive, horizontal mergers. The other kind is really a different piece of work all together. You'd have to have another kind of a law to do that.

I'm not interested in those. I think some of them are stupid, too. Some of them may make some sense. Some of them do.

But in horizontal mergers, what we're talking about is procompetitive stance against our foreign competition. That's the kind we're interested in here.

Chairman LAFALCE. Ms. Kaptur.

Mr. MCKINNEY. Could I borrow just a second? I'd like to get a statement from the Commerce Department in the near future disclosing who the foreign purchasing elements are of both our financial institutions and our American companies. I am totally convinced that we don't know who some of these foreign players are but I would like to see a requirement of full disclosure in the future.

I don't know who Sir James Goldsmith is, for instance. I know he's a living, breathing human being, but I don't know what the Antilles Foundation is or the Netherlands this or the Lichtenstein that. I would like to see all these organizations disclosing who they are and what they are doing.

I don't think that they should be able to own a significant part of American industry without some better disclosure.

Chairman LAFALCE. Thank you. Ms. Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman.

I want to commend you on holding this set of hearings. I've been following this issue carefully myself in our broader discussions of industrial competitiveness, and I certainly want to welcome the Secretary here this morning.

First, a bit of bookkeeping, Mr. Secretary. A few weeks ago, you were extended an invitation to visit my community in Toledo, OH. There are at least 500 business people that would love to see you there within the next 6 months if you can conform it to your schedule.

So perhaps when you go back today, you might direct your staff to unearth the invitation. They're holding up printing programs. And I would surely love to have you there.

Now that that's out of the way, I also want to thank you for your Department's efforts in cooperating to the extent possible with Members of Congress who are truly concerned with what is happening in the automotive industry across this country and across the world. And truly, if it had not been for the cooperation of Commerce on the auto parts conference that we recently held up in Southfield, MI, where over 100 U.S. companies participated, I really don't think that we would have gotten the kind of attention we feel is necessary in an industry that is undergoing enormous transition, as you well know from your extensive background in the area.

So thank you for caring about this industry.

Following on Mr. McKinney's remarks, I come from a community where a month and a half ago, American Motors Renault, which is basically owned by the French, announced that it was leaving. It's my community's largest employer.

I think one of the truly troubling facts about what is happening in the automotive industry is that you have foreign investment that can occur in this country, and under the laws as presently structured, they can pull up and leave and the community is left absolutely at the beck and call of people across the Pacific or the Atlantic who are making decisions that affect thousands and thousands of people's lives in my community.

I don't know what's going to happen in the auto industry, but I commend you for being interested in it. In fact, U.S. Trade Representative Clayton Yeutter asked me several months ago and I haven't been able to provide him with identified instances of unfair trade practices in the automotive industry. He said he'd be more than happy to begin litigating and trying to get decisions.

But if you have any suggestions along those lines, please let me know; I understand you made some comments about that earlier. I think we're looking for the list for our negotiations not only with the Japanese, but with other nations that are truly having an impact on this economy.

I wanted to ask just one basic question. As I read your testimony, and I've been reading some of the articles in the New York Times and all, I'm interested in this whole antitrust area. But I think I would feel more comfortable if it were placed in a broader bill that might have a title like, Vital Industries Trade Act or the Japanese Depressed Industries law—where only under certain circumstances do you permit this sort of antitrust activity to be waived and companies get together.

I guess my question to you is, as you propose this legislation, is it going to just stand on its own and be purely amendments to changes in Clayton 7, or do you perceive it as a part of a larger effort to really get at the heart of what is happening to this coun-

try, both in the manufacturing and agricultural sectors, where it's one of many tools that we might use to help American industry become more competitive?

Mr. BALDRIGE. Well, I think definitely it's part of a larger effort. The President, in his speech on trade policy last September 23, enumerated as part of his trade policy the direction to all of us to look at antitrust laws where they were preventing or hindering American global competitiveness. And out of that came this study, of which there are five different bills now.

I think all of them will go in separate bills. I suppose part of that is—I guess it is up to the Senate and House leadership—but they're being submitted as five separate bills.

But they're part of the overall policy and opponents frequently put up a straw man by saying that we're claiming that this will take care of the whole trade imbalance.

That's ridiculous. We've never said that. I mean, that's like a wasted argument because it's your opponent putting up a straw man and them knocking it down.

I agree with them. It's not going to change the whole trade balance. But it's one of the factors in the mosaic of competitiveness. And why shouldn't we do it if it's one of the things that will help?

This instance, I gave an example before you came about the heavy-duty truck company, problems in mergers and then with the foreigners coming in, the largest truck company in the world, they can buy them and our own people couldn't get together, and how that affects the suppliers to those American truck companies and on and on and on. And there are a lot more examples like that.

But this fear of what would happen under Clayton that stopped them in the first place. Not going ahead with it, they just thought it would be too expensive and they wouldn't win.

That's what we're trying to get at, is to make that more certain so that businessmen and lawyers can understand and you don't need a $500,000 a year Wall Street lawyer to come in and tell you, well, I don't know. It's 55-45.

That's what happens now.

Ms. KAPTUR. My time has expired, Mr. Chairman.

Thank you, Mr. Secretary.

Chairman LAFALCE. Mr. Wortley.

Mr. WORTLEY. Thanks, Mr. Chairman.

Mr. Secretary, American business is pretty much looking to you for leadership in the formulation of trade policy and combating unfair foreign competition.

I like your thinking and wish you had a few more allies.

You're suggesting that antitrust law changes will help, but I submit that those changes will just help a little bit. There's a lot of other things that trouble me as well. We've lost a couple of million manufacturing jobs in this country in the last 6 or 7 years to foreign competition. A lot of that is due to the fact that American industry is transferring technology and jobs overseas.

Up in my own area of Syracuse, which you're familiar with, we've seen Carrier Corp., Bristol Laboratories, even General Electric transfer jobs. When we lose those jobs, it creates a severe impact. I'm not sure just changing the antitrust laws can resolve the problem.

Are you concerned—I'm sure you are—about the flight of U.S. manufacturing jobs offshore?

Mr. BALDRIGE. Well, of course I am, Mr. Congressman. I'll tell you. Really, the thrust of your question, and of Congressman Levin's question, really bothers me. It's as if, well, it's not going to help as much as if the dollar went down another 30 percent or it's not going to help as much as if the European economy's picked up by 5 percent instead of 2 percent.

So, why are we talking about it? That's the impression I get.

I want to tell you, we are in a competitive fight and if you've been in any fights like that, as I know you have, you get all the help you can get. Just because this isn't as big a deal as getting all of Europe to grow faster is no reason not to do it, because if you ask the Cummins Engine president, who just lost half of his business to the Europeans because of our antitrust laws, you would say it was very important to him. It all depends on where you're sitting.

So, yes, I will agree, this is not the most important thing we can do. We're working on the most important things with the dollar, the increase in the economies abroad, the Baker plan for developing countries, and the Presidential list of trade policies include the use of 301.

We're doing all those. This is another piece in the fabric that we want to get through. And to say because it's not right up at No. 1 almost as if we shouldn't look at it, I hope we don't have that feeling here because we'll never get anything done.

Mr. WORTLEY. Well, would you have any feelings yourself on prohibiting foreign tax credits for American-based corporations?

Mr. BALDRIGE. No. I think we'd run into national treatment, then. We'd have the same thing done against us around the world.

Mr. WORTLEY. Well, of course, we have a lot of foreign governments that insist that we provide tradeoffs and assemble the products or buy a certain amount of spare parts, particularly in some of our aviation equipment, when we sell it offshore.

Those are not altogether fair. Sometimes you have to fight fire with fire.

Mr. BALDRIGE. Yes.

Mr. WORTLEY. It's 3 minutes past your departure time. I thank you very, very much.

Mr. BALDRIGE. Thank you.

Chairman LAFALCE. Mr. Secretary, I want to thank you very much for coming before the subcommittee. I wish we did have more time.

I understand the import of your legislative proposals, the seriousness with which you present them, and the widespread backing that the business community has offered to these proposals.

I personally haven't made up my mind. I do have questions, though, perhaps primarily because of the mergers that have taken place that you're not addressing, the horizontal mergers, and you are addressing——

Mr. BALDRIGE. No, I'm addressing the horizontal.

Chairman LAFALCE. The vertical mergers that have taken place.

Mr. BALDRIGE. And not the conglomerate. But Clayton 7 really doesn't pertain to those, except when they look at it. It pertains in

the sense that when they look at it, they find that there isn't any increase in market share.

Chairman LAFALCE. I think, though, in order to be successful, you're going to at least have to prove that some mergers have been prevented which would have enhanced the competitiveness of American industry, that the mergers that would be able to be accomplished in the future under your proposed legislation would, indeed, improve the efficiency and productivity of the industries involved, and that there would not be any adverse community impact. Or if there is, that there would be some Federal community impact program to help the communities adjust to any shutdowns or closings that might have to take place to help the individuals adjust. And maybe even couple this with some type of quid pro quo in your legislation so that, if you permit some mergers under a new antitrust law, that they wouldn't, then, merge and have all their other new plants open overseas.

I think that perhaps there's going to have to be some strings attached if you want to have a chance for success with your proposed legislation.

Mr. BALDRIGE. Mr. Chairman, may I say that—let's say that you're the University of Nebraska football team and that those other guys out there are the University of Iowa.

You just take all the things you said. That effectively ties up my right end, my defensive left tackle, part of my quarterback team, and so forth, and the other team doesn't have any of those rules at all.

I mean, we delight in piling on more and more rules on business. And there's a good motive behind all of them. What we end up doing is getting ours by the Europeans and the Japanese, who don't have that.

That's what we're trying to get away from, not get into more.

Chairman LAFALCE. Well, no, no. You see, what you miss is that the laws that were put on the books were put there to promote competitiveness.

Mr. BALDRIGE. Yes, sir.

Chairman LAFALCE. And what you're suggesting is that we change the laws to promote competitiveness.

Mr. BALDRIGE. Yep.

Chairman LAFALCE. And whenever a change is suggested, there's a burden of proof on the person proposing the change. The burden of proof is that there is some anticompetitiveness in those laws and that there would be some procompetitiveness in the new laws. And so we've got to do that.

Now, also, I don't think it's unfair to say that we ought to be concerned about community impact and impact on individuals. You're familiar with the import of that, so there's nothing wrong with my suggesting it. You're also familiar with the political process. And, there have been a million and one quid pro quos. As a matter of fact, a good many individuals—I'm one of them—thinks the quid pro quos should be part and parcel of any future Federal assistance, quid pro quos not just for the sake of quid pro quos, quid pro quos for the sake of improved competitiveness.

So I wouldn't just dismiss that out of hand.

Mr. BALDRIGE. No. No, I haven't dismissed it, believe me.

Chairman LAFALCE. OK.

Mr. BALDRIGE. Thank you very much, Mr. Chairman.

Chairman LAFALCE. Thank you, Mr. Secretary.

For a different point of view, we will now hear one of the Nation's leading experts in industrial organization, Dr. F. Michael Scherer, a visiting fellow at the Brookings Institution.

STATEMENT OF F. MICHAEL SCHERER, DEPARTMENT OF ECONOMICS, SWARTHMORE COLLEGE, SWARTHMORE, PA, AND VISITING FELLOW, THE BROOKINGS INSTITUTION

Dr. SCHERER. Thank you very much, Mr. Chairman. It's a pleasure to be here.

I will try to keep it a little bit short of 20 minutes because I know the committee has other obligations and the hour is late.

My formal testimony has been submitted for the record, so let me depart substantially from it and address some of the issues that Secretary Baldrige has raised.

I don't think there's any disagreement that U.S. industry is hurting. The key question here, it seems to me is antitrust the problem? Mr. Baldrige has admitted it's not the most important problem. But is it a significant problem at all?

I think that is the central issue.

From Secretary Baldrige's testimony, I noted an absolutely remarkable parallelism with the thinking of the Europeans in the 1950's and 1960's and, to a lesser degree, the 1970's.

I sent to Mr. Crane yesterday some excerpts from an excellent book on this subject, edited by one of the leading European industrial economists, Alexis Jacquemin. The parallelism is so striking that I would hope the committee would include excerpts from that book, "European Industry: Public Policy and Corporate Strategy," in its record.

Chairman LAFALCE. Without objection, we will include it.

[The excerpts referred to follow:]

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EUROPEAN INDUSTRY: PUBLIC POLICY AND CORPORATE STRATEGY

Edited by
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for European Policy Studies

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XIII

Large Firms in the European Corporate Economy and Industrial Policy in the 1980s

PAUL A. GEROSKI AND ALEXIS JACQUEMIN*

I. Introduction

The current crisis in the advanced Western economies and the renewed emphasis on market discipline and viability in the policy thinking of many governments have reinforced the urgency felt by many for a carefully constructed and coherent industrial policy within the Community. In this context, large firms are controversial institutions. They have grown with the Common Market and helped to shape it. Today they are socially and politically important because of the number of people they influence, directly or indirectly, as employees, suppliers, and customers. Severely affected by the current crisis and having met with great difficulties in their adaptation to it, large firms are now embroiled in industrial policy discussions. On the one hand, as large centres of economic power whose actions have a large social impact, they are natural targets for policy implementation; on the other hand, their size *per se* may be the subject of policy action.

That large firms will be subject to attention from the viewpoint of implementation seems reasonable to us. The administrative costs of directing attention towards (and monitoring the subsequent response of) the several hundred largest firms in the Community are clearly much lower than the costs of a much broader-based policy aimed at many thousands of decision makers, despite the fact that strategic behaviour between administrators and large-firm managers may somewhat deflect the basic policy.[1] Much more important is the fact that the largest firms are directly responsible for a large share of output, investment, employment, and exports in the Community, and indirectly responsible for a good deal more, because of the vertical links between them and smaller firms from whom they subcontract or to whom they

* Paul Geroski, Lecturer, University of Southampton and Visiting Professor, Catholic University of Louvain. Alexis Jacquemin, Professor of Economics at the University of Louvain-la-Neuve and Senior Fellow, Centre for European Policy Studies.

supply other services. As a result, any policy which alters the output, investment, or employment decisions of these firms will have large multiplicative repercussions throughout the Community; and any policy relating to the conduct of firms that is co-operatively agreed upon and implemented with these several hundred largest firms will effectively apply to several thousand more.[2] For these reasons we shall assume that attention is to be focused on large firms for purposes of implementation and shall not concern ourselves with this topic in this chapter.

Rather, we shall address ourselves to the crucial industrial-policy question of elaborating a framework to evaluate the economic performance, internal structure, and corporate management of these large industrial enterprises in light of the present crisis. The framework we develop will be applied to the particular question of identifying policy actions within the limits of the Common Market, which could improve the efficiency of large-sized firms.

In Section II we first briefly review the argument relating firm-size to the responses called forth by the challenge of large markets perceived in the late 1950s and 1960s, and discuss the available evidence on these issues. We then show in what sense the current crisis presents a different challenge than the one which led to the emergence and growth of many of Europe's corporate giants. In Section III we discuss the appropriate current direction and implementation of industrial policy with respect to large corporations, identify the main internal and external constraints faced by these firms, and make policy proposals.

II. Large European corporate size: old and new issues

Even before Servan Schreiber's well-known book,[3] Europeans were obsessed with the small size of their firms compared to US and (latterly) Japanese rivals, and with the differences in performance widely thought to be associated with that size difference. The 'crisis' of the 1950s and 1960s was generally perceived to be that of meeting the challenge of large markets and fully exploiting economies of scale and other advantages of size:

> . . . the creation of the European Common Market, with its open boundaries, has meant a profound change. Within the short period of ten years, barriers to free competition, whether consisting of customs duties, import quotas, the right of establishment, and so on, were largely torn down . . . Uncertainty increased because the environment was no longer stable.[4]

European firms were thought to have the incentive to become more competitive because of increasing competitive pressure from the US, Japan, and various Third World countries, as well as the newly enlarged

'home' market which opened up before them. In the realm of policy, the need was strongly felt to set up:

> . . . a framework allowing European undertakings to acquire the size and means to confront . . . industrial dinosaurs. . . .[5]

> . . . the aim to be achieved is to make the EC into an oligopolistic market. This is because it is concentration [which] . . . result[s] in the advantages that are to be expected from the restructuring of European industry. . . .[6]

Indeed, the challenge of such scale economies was felt to be so strong that many were willing to sacrifice potential diversity of products by encouraging the concentration of production on a relatively small range of goods.

The response to this mutation was a sustained period of intense merger activity, starting in the late 1950s throughout the advanced Western economies, and reaching historic peaks in the middle and late 1960s.[7] The principal result was that the largest firms' share in overall Community economic activity increased quite substantially. In Britain for example, the share of net output of the largest 100 firms rose from 27 per cent to slightly over 40 per cent from 1953 to 1970. By 1965 the 50 largest European firms had 15 per cent of Community gross output; by 1979 this had doubled to 30 per cent.[8] In countries like West Germany and the UK, during this period, the increased concentration of activity in markets (however narrowly defined) was mainly due to merger activity.[9] Widespread increases in market concentration appear to have occurred elsewhere in Europe as well.

This private-sector activity was evidently prompted by a number of factors, including the increased competitive challenge facing the Community and the enhanced opportunity that the EC's formation gave for exploiting scale economies. However, whatever the details of private-sector motivation, the 1960s also saw a happy congruence between private and public goals. Weak anti-merger laws, their even weaker implementation,[10] and the occasional enthusiastic government promotion of particular mergers fuelled the merger boom and hastened the transformation of the European economy.

The arguments concerning the advantages of size, which can and were used to justify such policy actions directed at increasing firm size, are well known.

The clearest and least ambiguous advantage of size is that it is necessary to exploit various scale economies, allowing production to occur at lower real input cost per unit of output. Such economies arise from advantages to division of labour, overcoming indivisibility, and so on. However, it is worth recalling that these economies are more restricted in scope than is thought in popular discussions, for purely

pecuniary economies can decrease average costs with size. That is, lower input prices could be based not on the economies of bulk transactions, but rather on enhanced bargaining power which does not lower real input costs, but merely redistributes profit between firms. Along with advantages in large-scale production of a single product, 'economies of scope' or cost complementarities in producing different goods may give rise to multi-product economies of scale, encouraging the production of a broad range of goods in greater or less depth (depending on the interaction between product-specific scale economies and such economies of scope). Aside from obvious examples like joint products, such complementarities may be created by shared indivisible inputs, or inputs with a public good character.[11]

A second advantage of size is a little less well known. Quite clearly there are costs to making transactions in a market, and, in certain situations, it is reasonable to replace a market by an institution which co-ordinates such transactions internally.[12] The necessity to bargain in bilateral monopoly situations (with the specialist behind and in front), the uncertainty generated about final demand, the excessive inventories that need to be held, and so on, can easily overwhelm whatever division of labour advantages there are. Hence, situations which are characterized by a great deal of uncertainty, bilateral monopoly or oligopoly, information asymmetries, incentive problems, high monitoring costs, sunk costs, etc., are all liable to be situations in which use of a market to make transactions will be too costly, and in which it may prove more efficient to internalize these transactions within an institution, such as a privately owned firm. Appreciable firm size may thus be a response to market failure, and quite independent of scale economies.[13]

Of course, to exploit such advantages, the 'internal market' must be designed in a manner capable of dealing with the market failure which brought it into existence. The appropriate structure of a firm depends upon its strategy, broadly conceived to encompass product range, scale, growth method, geographical spread, and so on.[14] One of the simplest structural distinctions that can be made is between functionally organized and divisionalized firms: i.e. between firms whose activities are organized on the basis of functional divisions, like marketing, production, and so on, and firms whose activities are organized on the basis of products. The advantages of the former are that the division of labour can be exploited within functional groups. However, in larger, more diverse firms such advantages are generally outweighed by the disadvantages of overlong communication lines and overloading of top executives, who are forced to neglect strategic thinking in order to monitor and administer the organization. In this case, divisionalization and the creation of independent profit centres will facilitate the control which the top can exert over the entire organization, thus freeing top

management from the bulk of administrative tasks without sacrifice. It has been noted in several empirical studies that divisionalization (when it is the appropriate strategy for a firm to pursue) is an organizational response which can increase a firm's efficiency and profit.[15] Indeed, one of the extreme manifestations of this view argues that '. . . the modern corporation is mainly to be understood as a product of a series of organizational innovations that have had the purpose and effect of economizing on transaction costs . . .'.[16]

Contrasting with the previous arguments, it must be recalled that, well before the onset of the 1970s crisis, numerous econometric studies put into question the view that higher profitability, faster growth, and more intensive research activity could be expected from larger European firms.[17] Most authors find no (or a negative) relationship between firm size and profitability. Very similar results have been obtained by looking at the consequence of mergers, which usually appear to result in lower profits and sometimes even in lower growth for the acquiring firm.[18] Since these effects have been observed for as long as seven years after a merger, it is hard to argue that they reflect transitional costs. Certainly more direct studies of the productivity effects of mergers confirm that the efficiency claims in favour of most mergers are either imaginary or else vastly inflated.[19] Direct estimation and measurement of single and multi-product scale economies similarly confirms that few of the larger plants of more heavily concentrated industries can be justified by scale economies.[20] The growth rate of sales seems to be more or less independent of firm size, which suggests that no comparative dynamic efficiencies exist. More direct study of this in the voluminous literature on the relation between firm size and research and development[21] has produced a large amount of evidence '. . . against the hypothesis that a necessary condition for technological change and progressiveness is that firms should be large scale and dominate the market in which they operate . . .'.[22]

Whatever the advantages of large firms in terms of productive efficiency or dynamic efficiency, it is also fairly clear that those with large plants have far more than their share of industrial relations trouble. They also face subtle and difficult problems in the designing of jobs which are sufficiently enriching and stimulating to bring forth maximum effort on the part of the work-force without the need to pay enormous wage premiums.[23] Finally, little evidence has emerged to contradict the view that large firms simply aim to stabilize their returns, and that they use their positions of market power to cushion, reduce, or transfer risk.[24] This suggests that large firms frequently can be very slow to make a decision, and very averse to risk in outlook.[25] Perhaps the best examples of this are to be found in the all-important areas of technical dynamism. It is common to find that corporate

research projects are unduly conservative, that basic breakthroughs occur in university or government laboratories, or via private individuals,[26] and that large firms can be slower to adapt to new technology than medium-sized firms.[27]

Whether or not one wishes to characterize the events of the late 1950s and 1960s as a crisis, there is no disputing that it was widely felt that competitiveness of European industry needed to be raised. The events of the 1970s are a different story. The characteristics of the current crisis are, at base, supply shocks:

> . . . it is not the policy choices but rather the policy options that have worsened in the 1970s, with supply shocks driving the stagflationary process. . . .[28]

These shocks seem to be several in variety. One is clearly the large rise in raw material prices, with oil only the most obvious example. Apparently linked with this is a sharp slowdown in total factor productivity growth, and the growing incursion of various Third World or newly industrialized countries into traditional Western industries, such as steel or shipbuilding. In partial response to the lengthening stagflation, there have also been a series of quite radical changes or reversals in government policy (including, latterly, rises in interest rates to quite stupendous levels and sharp cutbacks in government spending) which can only have added to the confusion.[29] More generally, rapid and variable rates of inflation linked with a larger variability of relative prices, more erratic growth, and greater instability of exchange and interest rates, have generated a higher degree of uncertainty.

The policy and private sector response required to meet such shocks is fundamentally different from the 1960s. Important supply shocks require the ability to adapt to a new environment, to create and rapidly implement new techniques or methods of operation, and to shift resources into new fields and away from traditional areas of activity. It is less a question of minimizing costs, given known techniques and fairly stable factor prices and product demand, but more one of finding and developing new techniques and products appropriate for very different factor price constellations and of shifting grounds of comparative advantage.[30] Indeed, in such cases, the need for flexible and reasonably rapid adjustment to new circumstances is liable to require some sacrifice of static efficiency; and the need to do things fairly rapidly impedes the intensive study and perfection needed to do them well.

Thus, the challenge of the 1970s requires a different response from that of the 1960s. What is more, it requires a response conditional on the response made to the earlier crisis, which led to the creation of the current giants of European industry. Indeed, today the European

economy is dominated by a group of very large firms responsible for a very large share of aggregate activity however measured. In this respect, Europe is not different from the US and Japan: i.e both the relative and absolute size of European firms now compares with US firms, while in absolute size they are much larger than Japanese rivals. Also, like the US and Japan, European industry is dominated by fairly stable groups of large firms, except that they vary in national origins. But despite these similarities, performance of large European firms, and especially their rates of return, is definitely inferior to either of their sets of rivals. (See the Appendix for preliminary information at the overall and industrial levels.)

These results suggest that size is not sufficient for greater efficiency in large firms. The poor performance of European firms would not, it appears, be ameliorated by direct policy action on size, encouraging the growth of large firms. In view of the crisis it is liable to be more productive to concentrate attention on how a firm's structure and business-mix spread risks; on whether its internal organization favours flexibility and encourages the taking of important strategic choices; on the appropriateness of its non-price as well as price policies in the face of world competition; on whether its social, political, and legal environment offers an incentive scheme and not a paralyzing constraint; and so on.[31]

III. Corporate structure and new industrial policy

Large corporate size is neither a 'necessary' condition for efficient adaptation to large changes in the economic environment, nor a 'sufficient' condition for efficient adaptation to a more static environment in which competitive efficiency in the usual sense is important. It therefore follows that while large firms are important from the point of view of implementation, size is not a major focus of policy action from the point of view of policy goals. Clearly, a large multi-unit business enterprise must replace small traditional enterprises where scale economies and efficiencies due to learning are important. This is also true where administrative co-ordination permits better achievement of lower costs and higher profits through internal allocation mechanisms than co-ordination by the invisible hands of market mechanisms. In industries and activities which use capital intensive, technologically advanced, high-volume processes of production, which require specialized skills, and other services and facilities lowering the cost of transacting business, and which demand a careful co-ordination of output flows to meet the demands of national and world markets, a predominance of large industrial groups may well be a necessary condition for static and dynamic efficiency.[32] But this necessary condition must be supplemented by others ensuring the realization of the potential

firms within that group the figure was 3.92 per cent, while European firms only achieved 3.15 per cent. Inspecting the 100 largest firms in each of the three geographical areas produces a very similar picture: 4.8 per cent, 2.7 per cent, and 1.4 per cent respectively for the US, Japan, and Europe. For European firms, a reduction in this ratio compared to previous years was evident, coming mainly from a deterioration in performance of British and French companies. On the other hand, the figures for European firms may be unduly high because of government subsidies.

Of course, the ratio of net incomes to sales is a performance measure of less than universal appeal, but these figures seem consistent with a wealth of anecdotes and casual observations concerning inferior European performance. What is important from our point of view is to emphasize that this observed poor relative performance by European firms appears not to be caused by unfavourable size differentials *vis-à-vis* the US, and cannot be due to lack of exploitation of the advantages of size *vis-à-vis* Japan.

The material discussed in the previous two paragraphs was derived from highly aggregated figures. From an analysis of the data published by *Fortune*, further information has been obtained for twelve broadly defined industries and the five leading firms within them for Europe, Japan, and the US (where available).[63] In general, the same results turn up at this more disaggregated level. On the one hand, European firms are of comparable size to the US (except in petroleum) and generally much larger than Japanese firms. Furthermore, the degree of size asymmetry (measured by the Herfindahl index) among the European leaders for nine comparable industries is not obviously and systematically different, it is lower among the US leaders in five cases, but higher in four cases. (From 1974 to 1980 there has been no marked increase in this index.)

On the other hand, European performance is inferior to that of Japanese and US firms (drink is one exception), although there is much more variation in performance than in size. Finally, it is worth remarking that, with a few exceptions—such as food and drink, the five largest European firms in each industry have different national origins. Thus, while the concentration within each sector is roughly comparable across the European countries, the cultural, legal, and policy differences within European industries must imply a significantly lower cohesiveness than implied by the concentration levels for US or Japanese industries.

Notes and Sources

[1] This problem of strategic interaction between regulator and regulated has been the subject of much attention in the US. One manifestation is the so-called

'Averch-Johnson' effect, in which firms regulated by rate of return inflate their capital base. For general discussions see W. Shepherd and C. Wilcox, *Public Policies towards Business*, R. Irwin, London, 1975, Part IV.

[2] As a slight digression, it is worth noting that much the same point applies to the implementation of macro-economic policy, since there is a close relationship between the decisions of these large firms and the movement of macro-economic variables. It is clear that the short- and long-term supply decisions of these firms, as well as managerial preferences and their emphasis on research activity, affect macro-economic growth and development if only because most investment and research undertaken privately is undertaken by these firms. A 'micro-to-macro model' of the Swedish economy has been developed at the Industrial Institute for Economic and Social Research of Stockholm. For recent theoretical work in this area, see H. Odagiri, *The Theory of Growth in a Corporate Economy*, Cambridge University Press, 1981, and T. K. Ng. 'A micro–macro-economic analysis based on a representative firm', *Economica*, No. 49, May 1981, pp. 121–39.

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[31] An interesting recent illustration of the role played by the non-price variables in the competitiveness of European industry is given in the 1979 *Report* published by European Management Forum, Geneva. They argue that German and Swiss companies excel in terms of sales and marketing acumen, the quality of their products, their ability to deliver on time, and the dependability of their after-sales services and that Germany and Switzerland benefit from a financially dynamic environment, little political polarization, and a high degree of socio-political consensus and stability. On the contrary, France is rated highly on its industrial efficacy resulting from major restructuring efforts, but is perceived to lack commercial spirit and to have a too strong socio-political polarization.

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Dr. SCHERER. Let me just quote very briefly from an article in it by Jacquemin and another leading European economist, Paul Geroski. They say,

> Even before Servan Schreiber's well-known book, Europeans were obsessed with the small size of their firms compared to U.S. and (laterally) Japanese, rivals, and with the differences in performance widely thought to be associated with that size difference.

I skip then a page and go on to page 345.

> The response to this mutation was a sustained period of intense merger activity, starting in the late 1950s throughout the advanced Western economies.

And then they describe the results of this merger wave on concentration of European industry. They then go on two pages later to note findings very similar to the ones I articulate in my formal testimony, but findings that have also been reached by European scholars; namely, that, by and large, the giant firms that were created by these mergers were not any more efficient and, indeed, may have turned out to be less efficient.

Secretary Baldrige presented for us a chart showing the leading enterprises outside the United States and the ten leading U.S. enterprises.

Of those 10 U.S. enterprises, only 2 or 3 would be on anyone's list of superior performers. Many of those leading enterprises would be candidates for dinosaur-of-the-year award at one time or another in the last half dozen years.

It is not at all obvious that big means more efficient, that big means more effective in foreign trade.

Let me go on to my own study of the effects of mergers in the United States. We looked at about 5,000 mergers made between 1950 and 1976. What we found was that, on average, the profitability of the companies acquired went down.

Now, it's very hard to reconcile declines on average in profitability with any assumption that mergers on average increased efficiency and, hence, competitiveness.

Now I agree fully with Secretary Baldrige's statement, and I jotted it down, so I quote him exactly—"Mergers can"—"can" underlined—"produce more efficient firms."

There's no question about that. I've seen mergers that have produced more efficient firms. The trouble with the statement is that businessmen typically are swayed by anecdotal examples. They do not tend to look at the broad statistical pattern.

If, however, one is trying to formulate public policy, as the administration here is proposing, one must look at the broad statistical averages.

What our study suggests rather strongly is that, on average, mergers have been efficiency decreasing, not efficiency increasing.

Now I grant, our study covered an historical era when the constraints against large horizontal mergers were relatively stringent. Secretary Baldrige referred repeatedly to the fact that what this new law would do is codify what the enforcement authorities are currently doing. But the fact is, that represents a major change from the policy that was enforced by the Eisenhower administration, by the Kennedy administration, by the Johnson administration, by the Nixon administration, by the Ford administration, and by the Carter administration.

There was a bipartisan policy of pursuing tough restraints toward horizontal mergers.

Secretary Baldrige alleges that this tough policy has hurt American competitiveness. Under probing from you, Mr. Chairman, he adduced two elements of evidence.

First of all, he said that a lot of mergers didn't get off the ground because the business managers saw the prospects under antitrust as uncertain, and it was embarrassing to have to back off once one had made the merger and then it was found illegal.

A careful study by Kenneth Elzinga, of the University of Virginia, has shown that when a firm was forced to back off from a merger, an average 7 or 10 years had elapsed between the time the merger took place and the final divestiture order.

I might note furthermore that Secretary Baldrige's remarks reflect a mentality that probably did exist among U.S. businessmen 15 or 20 years ago. That mentality has changed radically in the last 15 or so years.

Business firms now spin off subsidiaries the way Washington street vendors sell hot dogs. It's not considered an embarrassment at all to acquire an enterprise and then subsequently to sell it off.

Indeed, our studies show that something on the order of 30 percent of all the 5,000 or so acquisitions covered by our study were subsequently spun off.

So I really don't think that evidence cuts.

That leaves us only with his evidence on the alleged difficulties Paccar experienced in acquiring Mack, White and Freightliner.

I don't know the facts. It would be interesting to explore those facts. It seems to me, however, that, on average, there's so much evidence that merger policy has done much to impair our industrial competitiveness. The proper policy, I would suggest, is not one that the legislation before you adduces; that is to say, putting the burden of proof on the Government to prove that there will be an enhancement of market power.

That's a very difficult burden of proof for a bunch of bureaucrats to sustain.

Rather, we ought to have a policy under which one maintains a strong presumption against concentration increasing mergers and then, if a merger of Mack and White and Freightliner and Paccar will lead to substantial efficiencies, let them come forward and bear the burden of proving that the efficiencies their merger will confer in fact outweigh any anticompetitive costs.

I think this would have two benefits. It would put the emphasis where it really belongs; namely, on that minority of cases where substantial efficiencies will result from merger. Second, and quite importantly, it would force business managers to think their mergers through more carefully so that we would have fewer mergers that turned out to be industrial disasters, reducing efficiency rather than enhancing it.

On the question of policy, I would simply add one further remark, and that is this. Perhaps I don't understand the proposed legislation on import relief through mergers. What I find particularly puzzling is the star chamber nature of the proposed proceeding. That is to say, all the documentation would be kept secret.

Why should we keep such documentation of advantages from merger secret from the public and from the enforcement agency? At the very minimum, I should think one would want to open up those proceedings to sunlight so that the public can see whether it is in fact getting substantial benefits in exchange for an exemption from antitrust rules.

Thank you very much, Mr. Chairman.

[The prepared statement of Dr. Scherer follows:]

Testimony of F. M. Scherer

Before a Subcommittee of the

Committee on Banking, Finance and Urban Affairs

U. S. House of Representatives

March 11, 1986

The Committee has asked me to address certain issues raised by the Administration's antitrust law amendment proposals. My testimony will be confined to the two proposals concerning mergers, since my recent research, supported inter alia by the National Science Foundation, Brookings Institution, and Federal Trade Commission, has been in that field. One proposed bill would in effect shift the burden of proof on concentration-increasing mergers from the merger partners to law enforcers, for a plaintiff would have to show that a merger will increase the ability to exercise market power rather than merely showing, as in the past, that the tendency may be substantially to lessen competition. The other merger bill would provide a limited exemption from the anti-merger laws for industries found by the President to be entitled to relief from import competition.

The main motivation of the Administration's proposal, paraphrasing Attorney General Meese's statement of February 19, is to eliminate antitrust provisions that shackle American industries in global competition, to promote economic efficiency and consumer welfare, and to encourage innovative business activities. The key question is, will a substantial

relaxation of the merger laws in fact help achieve those goals?

Evidence on the Efficiency Consequences of Merger

Over the past several years, David Ravenscraft and I have been assembling and analyzing an extensive data base on the success of mergers in American manufacturing industry. Our sample of corporations included some 471 manufacturing enterprises that accounted for roughly three-fourths of all acquisitions by asset value during the period 1950-1976. To the individual "lines of business" on which the companies reported profit and loss and balance sheet data information to the Federal Trade Commission for the years 1974-1977, we linked information on more than 5,000 mergers made between 1950 and 1976 and on the hundreds of business unit sell-offs effected by the companies between 1974 and 1981. In addition, we conducted case studies of fifteen mergers that subsequently led to sell-off. From the analysis of these data, a large number of conclusions have emerged. I shall try here to summarize them very briefly.

1) Of the acquisitions covered by our study, somewhere between 25 and 35 percent were subsequently sold off or divested.

2) Our case studies revealed that the typical reason for sell-off was management dissatisfaction with the performance of an acquired unit or closely related

units. Poor performance in turn followed from three main variables: bad luck, managerial incentive breakdowns attributable to the new and more cumbersome organizational structure into which the merged unit was fitted, and inability of the parent companies to exercise effective managerial control over their acquired units, especially when problems emerged.

3) Our quantitative analysis confirms that low profitability is the most important factor "explaining" sell-off of acquired units. On average, in the year before sell-off, a unit to be divested had an operating income / assets ratio of minus 1 percent. Non-divested units had average returns of plus 13.9 percent.

4) Contrary to popular impression, the business entities acquired were highly profitable before merger occurred. For a three-year sample, unweighted average operating income was 20 percent of assets in the year before merger for the acquired entities, compared to 10.9 percent for all manufacturing corporations.

5) The profitability of acquired units surviving sell-off also dropped, but less drastically, following merger. In our larger sample, it took about 17 years for the superior baseline pre-merger performance of the acquired but retained units to erode completely. In a smaller but better matched pre- vs. post sample analysis, the decline took only about seven to ten years. The

decline occurred even though parent companies were relatively generous in providing investible funds to their retained subsidiaries (which was not the case for some of the sold-off units).

6) Related business acquisitions (those made in the same broad industrial group) and horizontal acquisitions were more successful in maintaining their baseline profitability than purely conglomerate acquisitions. Obversely, purely conglomerate acquisitions were most likely to be sold off. The only category of mergers that achieved a slight increase in baseline profitability were those we called "mergers of equals," in which the two partners differed from another in size by no more than a factor of two. We attribute these differences to differences in managerial effectiveness: more effort is likely to be put into making mergers of equals "work," whereas with asymmetric conglomerate acquisitions, the parent company's skills are least well-suited to industry-specific problem-solving.

7) When I refer to "baseline profitability," I mean profitability before asset and depreciation adjustments explicitly attributable to merger are made. When one analyzes profitability on the basis of post-adjustment magnitudes, one finds that the average acquisition was significantly less profitable post-merger than non-acquired units with similar market shares in the same

industry. The rates of return achieved were lower than those typically imposed by large U.S. corporations in evaluating new capital investment proposals.

8) Tender offer acquisitions in our sample were on average much less profitable post-merger than non-acquired lines of comparable industry location and market shares. The main reason for their inferior profitability was the large take-over premium typically paid, which inflated asset values and hence depressed profit returns. When accounting adjustments are factored out, one finds that the tender offer acquirers neither significantly improved nor significantly reduced the baseline profitability of their acquisitions.

These findings, I believe, cast doubt on the Administration's fundamental assumption that mergers are efficiency-increasing, and hence are likely to enhance U.S. companies' international competitiveness. To be sure, <u>some</u> mergers increase efficiency. I can recite at length examples from my own consulting and case study experience. But if one is going to enact a general public policy concerning mergers, one must be concerned with the <u>average</u> tendencies, not with selected cases.

It might be argued that the kinds of mergers the Administration's policy change will encourage would have violated accepted Celler-Kefauver Act precedents, and thus are not present, or present only in insignificant quantities, in

our statistical data base. Although our sample does include large numbers of horizontal mergers, the market shares involved were typically small. To achieve full insight into the effects of mergers that substantially increase seller concentration, it is probably necessary to seek a different data base. Fortunately, such data, though not as richly detailed as ours, exist. Until recently, all of the major European nations had merger restraints much less tough than ours. All experienced significant amounts of horizontal merger activity, much of which would have been found illegal in the United States. During the 1960s, the British government had a policy of explicitly encouraging mergers through its Industrial Reorganisation Corporation in the hope of building larger, stronger enterprises better able to hold their own in international trade.

Those European "experiments" have been the focus of both qualitative and quantitative research. The most ambitious study analyzed the effects of mergers across a sample of seven nations -- Belgium, France, West Germany, Holland, Sweden, the United Kingdom, and the United States. The authors summarized their findings as follows:[1]

> No consistent pattern of either improved or deteriorated profitability can therefore be claimed across the seven countries. Mergers would appear to result in a slight improvement here, a slight worsening of performance there. If a generalization is to be drawn, it would have to be that mergers have but modest

1. Dennis C. Mueller, ed., The Determinants and Effects of Mergers (Oelgeschlager, Gunn & Hain, 1980), p. 306.

> effects, up or down, on the profitability of the merging firms in the three to five years following merger. Any economic efficiency gains from the mergers would appear to be small, judging from these statistics, as would any market power increases.

Another study concerned more narrowly with productivity increases following large mergers in the United Kingdom concluded as follows:[2]

> What has our enquiry revealed? Taking a broad sweep of the results the picture is one in which it is difficult to sustain the view that merger is in fact a necessary or sufficient condition for efficiency gain. In many cases efficiency has not improved, in some cases it has declined, in other cases it has improved but no faster than one would have expected in the absence of merger ... There are one or two cases where we have seen an efficiency gain which has followed from the merger, these cases being where superior management has gained control over more resources. This aspect was probably the dominant view in the thinking of the [Industrial Reorganisation Corporation], but the evidence also forces us to recognise that it is just as likely that a merger based on such reasoning will fail as that it will succeed.

Thus, the European experience also provides no consistent support for the Administration's supposition that large-scale mergers will <u>on average</u> lead to efficiencies and improved competitiveness. The reason, I believe, is three-fold. For one, larger organizations are more bureaucratic, and hence have more difficulty than smaller organizations in realizing the efficiency levels that might in principle be achieved. Second, in many industries, but surely not all, my own

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2. Keith Cowling et al., <u>Mergers and Economic Performance</u> (Cambridge University Press, 1980), p. 370. For another extraordinarily carefully conducted British study whose title discloses its findings, see Geoffrey Meeks, <u>Disappointing Marriage: A Study of the Gains from Merger</u> (Cambridge University Press, 1977).

research reveals, the main advantages of large-scale organization are realized at firm sizes well below those associated with large market shares.[3] Third, To the extent that large size does carry advantages, it is more apt to be size achieved through internal growth and success in the marketplace of products and services than size achieved through merger, which must overcome important historical and organizational legacies. Once plants are built and product strategies implemented, it is hard to unbuild or reposition them. It is also difficult to fuse two quite different "management cultures."

One further point deserves mention. A rationale sometimes advanced for mergers is that only by achieving large size can companies become vigorous technological innovators. I recall attending, in the early years of my career, a conference at Fontainebleau in which this was the central theme, articulated inter alia in a keynote address by Valerie Giscard d'Estang, then finance minister of France. The Europeans believed it then; the Americans were skeptical. The weight of American scholarly opinion has not changed since then, because study after study has shown that innovative activity does not rise disproportionately with size, and that the most active innovators are small technology-oriented firms, often operating on a venture capital startup basis. In Europe, however, the weight of scholarly opinion has changed

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3. See F. M. Scherer et al., The Economics of Multi-Plant Operation: An International Comparisons Study (Harvard University Press, 1975).

-- more in line with the American view. There have been numerous studies of the relationships between firm size, market structure, and innovative activity in various European countries. Their typical result has been similar to what those studying the American economy have found -- that large firm size and substantial market concentration are neither uniquely nor consistently conducive to the conduct of research and development and the implementation of technological innovations.[4] Exceptions exist, to be sure. A substantial concentration of effort is required to develop a Concorde supersonic aircraft or a fast breeder nuclear reactor. But they must be recognized (and are treated by government agencies) as just that -- exceptions.

Market Power and International Competitiveness

There is another facet of the merger question to which far too little attention has been paid. Suppose an industry is threatened by tough foreign competition - i.e., by firms with at least equally low delivered costs and equally high product quality. Suppose firms in the U.S. market are allowed to merge until they have what appears to be substantial oligopoly power <u>within</u> the nationally defined U.S. market. Does the existence of a strong import challenge ensure that their power to raise prices within the domestic market will not be exercised? The answer is a clear and unambiguous, No!

4. Alexis Jacquemin and Henry de Jong, <u>European Industrial Organisation</u> (Macmillan, 1977), pp. 148-156.

The reason for this perhaps surprising answer is grounded in new developments in economic theory. It used to be thought that if a core of cooperating domestic oligopolists were confronted by the threat of entry, they would hold their prices at the "limit price" -- that is, a price just below the potential entrants' minimum delivered unit cost, thereby keeping the entrants out. But if entry occurs only gradually over time, e.g., a few percentage points of the market per year, and if entry accelerates in response to stronger profit stimuli, it turns out that this "limit pricing" prediction can be invalid. Rather, the long-run profit-maximizing strategy for the oligopolistic group is to hold price substantially above the limit price, encourage the more or less gradual incursion of the outsiders, and to experience over time declining market shares.[5]

This is not merely a theoretical pipe dream. There is substantial empirical evidence in support. Some of the strongest evidence for the United States occurs for a period during which we performed a unique economic experiment. In the early 1900s, the United States experienced a massive, preponderantly horizontal, merger wave that put together numerous dominant or semi-dominant enterprises with substantial monopoly power in their markets. Caves and others

5. The pioneering work, by Darius Gaskins (former chairman of the Interstate Commerce Commission) and Morton Kamien and Nancy Schwartz, is very difficult mathematically. For a more elementary exposition, see my text, Industrial Market Structure and Economic Performance (Houghton-Mifflin, 1980), pp. 232-242.

have recently analyzed what happened thereafter.[6] What they found was a tendency for prices to be elevated, and for the market shares of the dominant sellers to decline significantly over time, except when those sellers enjoyed the protection of high entry barriers.

That "experiment" occurred when the United States was an island economy, and when the principal threat to dominant sellers was other domestic firms. Now, however, the "most favored" entrants are foreign firms, not domestic firms. But the same logic holds. If a domestic oligopoly inclined toward cooperative pricing policies faces a set of foreign competitors over whom the domestic firms have no cost advantages, and if the growth of imports will occur only at a few percentage points of the market per year, the long-run profit-maximizing strategy (absent government protection) will be to set domestic prices high, spur the growth of imports, and steadily to yield market share to the importing firms. Nor is this merely a speculative possibility. I am convinced that some such scenario is what happened in the automobile industry, the steel industry, the heavy-duty electric motor industry, the zipper industry, and no doubt others on which I have much less knowledge.[7] Encourage mergers, and thereby

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6. Richard E. Caves et al., "The Decline of Dominant Firms, 1905-1929," Quarterly Journal of Economics, August 1984, pp. 523-546.

7. Further amplification is provided in my testimony before the House Judiciary Committee's Subcommittee on Monopolies and Commercial Law, Corporate Initiative (1981), pp. 26-54.

encourage import penetration! If mergers do confer power in the market, defined purely domestically, and if (as my merger effects research suggests) the efficiencies they yield are too small to give domestic firms a cost advantage over foreign competitors, it is a plausible outcome.

Policy Implications

The principal policy implication I would draw from my analysis for the present forum is that the Administration's proposed bill "To clarify and improve the analysis of mergers" is ill-conceived. It assumes a general set of efficiency consequences flowing from mergers for which there is no evidence, and it distributes the burden of proof wrongly. It makes government enforcement agencies, who are always at an information disadvantage, prove there is a significant probability that market power will be increased. I would instead propose a revision that retains the Celler-Kefauver Act's tough presumption against concentration-increasing mergers, but then, recognizing that <u>some</u> mergers do yield appreciable efficiencies, puts the burden of proof on the would-be merger partners to show that substantial and overriding efficiencies are likely to result. In addition to providing a better screen against mergers that significantly increase concentration but fail to yield any compensating benefits, such a policy would have another, more subtle but perhaps much more important, benefit. From our case studies and our statistical analysis, I am convinced that many mergers

occur without careful pre-merger thought about how the two organizations will be fused effectively and what strategy will be pursued to ensure that efficiencies result. The prospect of having to convince a skeptical judge that substantial efficiencies will be realized, like the prospect of hanging in a fortnight, could marvelously concentrate the mind. If it forced managers to think through their acquisitions more carefully in advance, it could save the nation from many ill-conceived, efficiency-reducing mergers.

As an economist, I find the proposed bill "To provide alternative relief for industries adjusting to increased imports" problematic. It seems curious to provide a remedy that permanently alters domestic market structures to deal with a problem that may be only temporary (e.g., because the dollar has temporarily risen relative to other currencies, as in the early 1980s) or that might be alleviated, if relief is possible at all, by shorter-lived remedies such as import quotas or (as in the motorcycle case) by tariff increases that automatically phase themselves out. Some of my fellow economists argue in favor of the bill because they know that quotas and tariffs are very costly to consumers in the short run, whereas the short- and long-term costs of concentration-increasing mergers are less clear. And given that Congress is going to insist that <u>something</u> be done when there is a significant import shock, it is better, they say, to throw companies the merger exemption sop as a way of avoiding the

more bitter quota or tariff medicine. Perhaps they are right, although I am not persuaded that the long-run costs of extensive merger activity are trivial. But if they are right, Congress should recognize the cynicism in the proposal -- that it is a way of avoiding the more bitter medicine Congress itself would demand.

Chairman LAFALCE. Thank you very much, Professor Scherer.

The administration has proposed five separate bills to, in their words, enhance U.S. competitiveness by changing our antitrust laws.

I have questioned whether they have any evidence that our existing laws have inhibited competitiveness, and have asked for evidence that change in laws that they advocate would enhance competitiveness.

I'm not satisfied that they have met that burden. However, let me ask you this.

Aside from the administration's proposals, do you think that our present antitrust laws are in need of any change to enhance U.S. industrial competitiveness? And if so, would you comment on the deficiencies in existing law and what your proposed changes would be and how your proposed changes, if any, might differ from the administration's proposed changes.

Dr. SCHERER. Yes, sir. I do think there is a problem. The major area of change was suggested in my conclusion. That is to say, I think the basically strict structural standard that was written into the law with Celler-Kefauver in 1950 is a good one. I think, however, there should be an explicit efficiencies defense with the burden of proof being borne by the respondent companies to show there are substantial efficiencies that will come from the merger.

To be sure, that kind of thing is informally in the law right now. That is to say, in the administrative procedures, one can come forward and try to convince the Justice Department or FTC that there will be efficiencies.

It's not, however, in the Supreme Court and lower court proceedings. There just isn't any such clear precedent.

I remember about 10 years or so ago, when I was at the Federal Trade Commission, we had a merger before us that probably violated the Celler-Kefauver Act, strictly speaking, but looked a lot like it might yield significant efficiencies.

We invited the companies to come in before the administrative law judge and present evidence of those efficiencies. They came. They tried. They failed. There simply wasn't evidence of the efficiencies.

I think the law should be changed, however, to implement such an efficiencies' defense.

The second area of change—I fully agree with the administration's position on treble damages. Some of the technicalities of it are beyond my economic ken. By and large, however, I think there has been an abuse of the treble damages legislation.

I should like to see trebling retained primarily for hard core price-fixing cases. For more normal types of violations of the antitrust laws, which are somewhat like contract disputes in many cases I should like to see single damages, and also the possibility of awarding legal fees where the plaintiffs have brought litigation capriciously.

I also think that it makes eminent good sense to increase the dollar threshold on interlocking directorates, as the administration has proposed. I don't believe that will have much effect on our competitiveness, but it seems that the historical standard is simply too low.

Chairman LAFALCE. Thank you.

Congresswoman Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman.

Mr. Scherer, I wanted to ask you if in your work in looking at other nations, if you have reviewed the depressed industries' law of Japan and the manner in which it identifies a little over two dozen industries in that country, including the aluminum industry and the steel industry, et cetera, that, then, once they are identified by the government, receive, although the Japanese deny it, different treatment in terms of imports that are allowed onto their shores? The companies within Japan work with the government to pull themselves out of their depressed status through a whole variety of mechanisms, including, I suppose you'd call it merger, but basically, it is to reduce capacity within the country, let's say in a given industry like aluminum, while at the same time becoming more competitive.

That obviously requires certain companies to be shut down, certain companies to receive greater investment because they may have more of a cutting edge in a certain technology.

I'd be very interested to know what your view is of that law, if you have any knowlege of it. And when the United States is in competition with a nation like Japan, and you have an economy that functions internally in that way, how in the world we can ever get ourselves into a position to compete when you're dealing with very different rules.

So, A, do you know of the law? B, do you have any comments on it? And C, as you look at the competitiveness challenges the United States faces, if it isn't antitrust where you think we should make changes, where is it, in order that our industries might be more competitive?

Dr. SCHERER. I am much more of a Europe watcher than a Japan watcher. So most of my knowledge of the Japanese situation is derived from the work of other scholars.

I think it's true that the Japanese do provide special assistance, special rules for industries that have been hit very hard. It's not clear that the purpose of those rules is to allow them to recover—I think that's the word you used.

Rather, the purpose of, and certainly, the typical consequence of, is having those industries withdraw in an orderly way, rather than in a disorderly way. That's the key intent of the Japanese policy.

The way it works is something like this. Say you've got the aluminum industry or the shipbuilding industry. You're no longer competitive in the world market, for one reason or another. You've got to reduce capacity.

So what happens, first and foremost, is that MITI comes along and says, OK, we've got to have a 30-percent reduction in capacity. What shall we do?

Well, MITI's in a political situation and it can't say, OK, firm A, you shut down. Firm B, you're the most efficient—you keep going full blast. They can't do that politically. No political body is able to do that kind of thing—in Japan, in the United States, or in Europe.

So what they do is apply a 30-percent across-the-board reduction.

Now that's inefficient. It's inefficient because there really are some less efficient firms. They should shut down. Market forces

would cause them to shut down, but the Japanese don't like the disorderly processes that go with letting the market work.

So, although Japanese business people in general are quite reluctant to merge, they then find that given this ultimatum from MITI, which doesn't make any sense, the only way to get around the ultimatum in an efficient way is to merge. Thus, the combined firm, one that ought to be shut down totally and one that ought to be kept going, can take its 30-percent quota and use it in a more efficient way.

What this is, is a second or third best solution. The merger here is a second or third best solution. The first best solution would be letting the market work. The second best solution, which is what the Japanese have tried, is letting MITI issue an ultimatum. But that's so inefficient, that they go to a third best; namely, merging.

The Europeans had a somewhat similar experience in the synthetic fibers industry. They were badly overcapacity. They had to cut back. The European Community authority therefore said, let's cut back right across the board.

There's been a very interesting study showing that this European Community ultimatum did cause the firms to cut back across the board and, therefore, chopped out the efficient firms with the inefficient firms. After that, the Community pulled back and let the market work.

After the European Community pulled out of the situation, it turns out that later capacity reductions were concentrated mainly on the less efficient plants. The more efficient plants, those that should have survived, did survive.

Now the question therefore is, why do you need a MITI, or why do you need a merger policy? Why not let the market work and select out for closure those units that are relatively inefficient and let the efficient ones survive?

It seems to me that only in the exceptional cases, and there are cases that can be spelled out, only in exceptional cases will merger help that process.

Ms. KAPTUR. Following on that, I ask myself the question, why not let the market operate? And I look at the United States in so many of these key areas—take metal fasteners, which are supposed to be used to put airplanes together. We can't make them any more and so we import them. We import 95 percent of our motorcycles, all of our VCR's. The steel market, the quota that was established, we're not even meeting that. It's supposed to be 18-percent import penetration and we're somewhere in the neighborhood of 23 to 25 percent and haven't been able to bring that down.

I look at machine tools, and that industry is going down the tubes in this country. Does efficiency mean that America loses her manufacturing base entirely? Is that what being efficient in today's world market means, when a country like Japan is able to retain some piece of its steel industry and some piece of its aluminum? We closed down the last nickel plant in America about a year ago in Louisiana. Copper mines—all of our workers are out of work out West.

Does being efficient in America mean that we don't have those jobs any more, at all? Is that what efficiency means?

Dr. SCHERER. I don't think it's quite that.

Ms. KAPTUR. Isn't that the trend we're on?

Dr. SCHERER. A lot of the hits we've taken have been the result of the very high value of the dollar in recent years. That is correcting itself.

There are, however, other cases where, even before the dollar soared in value, our industries were taking a very hard hit.

You mentioned motorcycles. I happen to have done a case study of the motorcycle industry. Harley Davidson—which was our motorcycle industry—Harley Davidson got into trouble in part because it totally neglected the small cycle market. Its only entry into the small cycle market occurred when it merged with an Italian firm and tried to import Italian motorcycles, but it just didn't work out.

The Japanese, who had pioneered the small cycle market, then began moving up and competing against the Harley Davidson "Hog." For a long time, Harley had not changed the design of its Hog. The Japanese came in with a very tough effort and began taking away Harley's market share in top-of-the-line cycles.

I should note that Harley was owned by AMF, American Machine and Foundry, during this period. AMF, to its credit, put a lot of money into redesigning the Harley Davidson Hog.

It came to the decision, however, should we spend the money on tooling up for a new motorcycle? And they said, no, it looks like a tough industry. We don't want to use our investable funds on that. To its later dismay, it decided to use them instead on oil field equipment, and, of course, that industry has totally collapsed since then.

In any event, it said, we don't want to make that investment in keeping Harley competitive with the Japanese. So AMF decided to sell off Harley Davidson and make it once again a free-standing corporation, with a member of the Davidson family as president and one of the principal financiers.

Since that selloff, since it moved from a conglomerate form of organization to a unitary organization, Harley has made the investments in the new cycle. It has streamlined its manufacturing processes. It has completely revamped its labor relations, which, under AMF, had become bureaucratized and ineffective. And as a small, nonmerged company, Harley, to be sure, with some tariff protection, may have reformed itself to the position where it has a decent go at it against the Japanese.

You don't have to be merged to be effective. Indeed, a small company with aggressive, hard-working management can make it at least as easily in most cases. I grant, again, there may be exceptions.

Chairman LAFALCE. Thank you very much, Ms. Kaptur. And thank you very much, Professor Scherer. We've had two excellent insights both from Secretary Baldrige and from yourself regarding our antitrust laws and suggested changes in them to enhance competitiveness. For that, we thank you and the Secretary.

The subcommittee will now adjourn.

[Whereupon, at 12:55 p.m., the subcommittee was adjourned, to reconvene subject to the call of the Chair.]

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